KLAUS ILMONEN

DYNAMICS OF EU CORPORATE GOVERNANCE REGULATION
– NORDIC PERSPECTIVES

DOCTORAL DISSERTATION
TO BE PRESENTED FOR PUBLIC EXAMINATION, BY DUE PERMISSION OF
THE FACULTY OF LAW OF THE UNIVERSITY OF HELSINKI
IN THE SMALL ASSEMBLY HALL ON FABIANINKATU 33, IN HELSINKI
ON SATURDAY 20 AUGUST 2016 AT 12:00 P.M.

Publisher: Klaus Ilmonen

Cover: Ilkka Suppanen

ISBN 978-951-51-2339-8 (paperback)

ISBN 978-951-51-2340-4 (PDF)

Printed by Unigrafia, Helsinki, 2016

TABLE OF CONTENTS

ABSTRACT

The significance of EU level corporate governance regulation has been increasing in the years following the financial crisis. At the same time EU regulatory initiatives in this field have been subject to much criticism. The corporate governance systems in the EU vary significantly and it has been argued that EU initiatives have not been adapted to corporate environments prevalent in member states. This has been argued to have decreased the competitiveness of listed companies and the financial markets in the EU. Several EU corporate governance initiatives have also failed or been subject to considerable political compromise emphasizing the challenging political nature of the EU regulatory system.

EU integration represents a model for coordinating interaction between different economies and political systems. Understanding how supranational systems work and developing regulation at this level remains an important venture. More attention is needed to adapt the design of EU regulation to the varied institutional environment across the EU. To be able to develop EU legal strategies and regulatory design in the field of corporate governance, a better understanding of the dynamics of EU policymaking remains important.

The goal of the study is to provide a basis for developing legal strategies used in EU corporate governance regulation in light of the challenges of the (i) varied regulatory requirements of different corporate environments in the EU and (ii) the supranational political dynamics of corporate governance regulation. This requires a better awareness of the factors that affect (i) the impact and effectiveness of different legal strategies and regulatory mechanisms in different corporate environments and (ii) the political dynamics of EU policy-making with respect to corporate governance regulation.

The study analyses corporate governance regulation in the context of specific environments of corporate governance and corporate ownership. With an emphasis on institutional and political aspects of corporate governance, the study analyses and compares the effects of different legal strategies in these environments; i.e. what the effects of different regulatory mechanisms have been on the relationships between corporate constituencies. The study focuses on corporate governance regulation in the context of concentrated ownership in a Nordic institutional environment. The study also analyses the political dynamics of EU policymaking based on economic theories of regulation and an institutional analysis of EU policy-making. The results of study include a framework for a corporate governance index that incorporates the prevalent institutional dynamic, as well as a qualitative model for developing regulatory policy at the EU level.

The study relates to comparative corporate governance research and to political economy analysis of EU regulation.

ACKNOWLEDGEMENTS

This study has originated from observations made in my legal practice in relation to corporate transactions, including IPO's and takeovers, involving Nordic companies with concentrated ownership. Having then worked with legislative and regulatory projects on takeover regulation, it has appeared that EU and international corporate governance regulation has not been adapted to the Nordic corporate environment resulting in unintended and unwarranted outcomes. At the same time the EU has provided a promising source for regulation that could circumvent entrenched or inefficient structures at national levels. Also, having worked with EU regulators at ESMA as an adviser on regulatory initiatives, it seems to me that initiatives and debate on how to develop EU regulation to meet the challenges posed by the varied corporate environment in the EU are welcomed. Developing EU regulation thus continues to be an important venture and I hope the study can make a contribution in this regard. In this context, I wish to recognize recent efforts in Finland in relation to legislative research. This line of scholarship is clearly important – especially with respect to EU law.

I have worked on this research project over a few years in a variety of different environments from university surroundings in Cambridge, Massachusetts to military camps in Northern Afghanistan. Differences in the political dynamic in these regions were so extreme as to force a researcher to acknowledge the existence of strong links between politics, economics and law. My experiences have convinced me that the political environment must be introduced into qualitative economic and legal models related to defining and understanding the dynamics of business enterprise.

I wish to thank my instructor, Professor Seppo Villa of the University of Helsinki, for his guidance, as well as my referee and opponent, Dr. Timo Kaisanlahti, and my second referee, Professor Alessio Pacces, for their valuable comments. I wish to extend my special thanks to Professor Mark Roe for his support and guidance during my period in the visiting researcher program at Harvard Law School, as well as to Professor Tom Berglund of the Swedish School of Economics in Helsinki for his continued encouragement.

The Finnish Foundation for the Advancement of Securities Markets (*Arvopaperimarkkinoiden edistämissäätiö*), the Jenny and Antti Wihuri Fund, and the NASDAQ OMX Nordic Foundation have generously supported my research, which is recognized with gratitude.

The dissertation is dedicated to my partners in law – the ladies and gentlemen of Hannes Snellman Attorneys, and especially to my partner in life – my wife Susanne, for their understanding and patience.

On Midsummer, St. John's Day, 2016

At 60º 0'23" N, 20º 1'54" E

Klaus R. Ilmonen
LL.Lic., LL.M.

PART I

INTRODUCTION

CHAPTER 1

STUDYING THE DYNAMICS OF EU CORPORATE GOVERNANCE REGULATION: LAW, POLITICS AND MARKET STRUCTURE

I. CONTROVERSIES OVER EU CORPORATE GOVERNANCE INITIATIVES

There has been considerable criticism of some of the key EU corporate governance initiatives[1], such as the debates surrounding the introduction of the Takeover Directive[2], the one-share-one-vote initiative[3] and the more recent EU corporate governance initiatives following the financial crisis[4]. It has been argued[5] that the EU is no more attuned than national regulators to properly identifying market failures for the purposes of regulatory intervention, that EU regulatory processes are vulnerable to interest group influence and that the regulatory outcomes at the EU level may not increase social welfare[6]. It has even been argued that the EU has failed altogether in its efforts to develop corporate law and that regulation in this field should be restricted to the national level[7].

It has proved challenging to introduce EU level regulation and regulatory outcomes have often been deemed unsatisfactory. First, introducing regulatory models at the EU level that take into account national differences in corporate governance systems has been difficult. This dissertation originates from the observation that EU corporate regulations have often been criticized for not having been adapted to different corporate environments. The application of

---

[1] *See* John Armour, *Who Should Make Corporate Law? EC Legislation versus Regulatory Competition* (ECGI - Law Working Paper No. 54/2005), *available at* http://ssrn.com/abstract=860444 or http://dx.doi.org/10.2139/ssrn.860444; John Armour & Wolf-Georg Ringe, *European Company Law 1999-2010: Renaissance and Crisis* (ECGI – Law Working Paper No. 175, 2011, Oxford Legal Studies Research Paper No. 63/2010), *available at* ttp://ssrn.com/abstract=1691688 or http://dx.doi.org/10.2139/ssrn.1691688; Luca Enriques, *Company Law Harmonization Reconsidered: What Role for the EC* (ECGI Law Working Paper No 53, 2005), *available at* http://ssrn.com/abstract=850005; Luca Enriques & Matteo Gatti, *The Uneasy Case for Top-down Company Law Harmonization in the European Union*, 27:4 U. PA. J. INT'L ECON. L., 939-998 (2006), Gerard Hertig & Joseph A. McCahery, *Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition?* (ECGI Law Working Paper No 12, 2003), *available at* http://ssrn.com/abstract=438431.

[2] Directive 25/2004/EC of the European Parliament and of the Council of 21 April 2004 on Takeover Bids, 2004 O.J. (L142) [hereinafter Takeover Directive].

[3] *See* Charlie McCreevy, Commissioner, Speech at the European Parliament's Legal Affairs Committee, October 3, 2007*, available at* http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/592.

[4] *See European Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Action Plan: European Company Law and Corporate Governance – a Modern Legal Framework for More Engaged Shareholders and Sustainable Companies*, COM(2012) 740/2 [hereinafter the Company Law Action Plan]; *European Commission, Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement, Brussels COM(2014) 213 final.*

[5] Enriques (2005), *supra* note 1.

[6] *Id.*

[7] Enriques & Gatti, *supra* note 1.

the same regulatory mechanism can have different results across a varied institutional landscape such as the EU[8]. Specific regulatory mechanisms may not be adapted to prevailing systems of corporate governance which may lead to unintended results. The structure of corporate ownership will affect the relevance of different regulatory mechanisms, as will the quality of enforcement, for example. This can disenfranchise specific governance models and prevent the development of a level playing field. There has been some concern in this regard that EU regulation has been ill adapted to an environment with concentrated ownership and to governance systems that have developed in this type of environment – such as in the Nordic region[9]. Key EU corporate governance regulation seems to have been adopted from jurisdictions with dispersed ownership and then applied across the EU without consideration for its effects in a different institutional environment[10]. As a result, it has been argued that the emphasis on developing corporate governance regulation should be at the level of national regulation; this criticism has also been vocal in the debate in the Nordic region[11].

Second, a number of EU initiatives in the field of corporate governance have failed before any new regulation has been introduced. For example, the EU efforts to introduce a mandatory break-through rule in the Takeover Directive and the one-share-one-vote initiative, that would have challenged the position of controlling shareholders, were not successful. It seems that time and again initiatives have been introduced that have not been politically feasible. It has been argued that even if the EU has issued a broad range of company law regulation the real impact of EU company law has been limited due to political compromises necessary on many occasions to enable regulation to be introduced at all. This has at times resulted in regulatory outcomes that have been argued to have been misguided and ineffective[12]. The impact of EU level corporate legal rules has been limited, for example, by the optionality sometimes provided in how the rules can be implemented. This was the case in connection with the Takeover Directive, where some of the mechanisms introduced by the EU Commission were strongly opposed – also in the Nordic region[13]. Yet the regulatory or policy concerns underlying those initiatives have not been wholly unwarranted. It has appeared that the form or design of the regulation, rather than the underlying policy, necessarily, may have caused considerable concern among incumbent dominant corporate constituencies who have then mobilized all available lobbying efforts to (successfully) counter the initiatives.

---

[8] Marc Goergen, Marina Martynova & Luc Renneboog, *Corporate Governance Convergence: Evidence from Takeover Regulation* 29 (ECGI working paper No. 33, 2005), *available at* http://ssrn.com/abstract=709023.

[9] *See* Jesper Lau Hansen, *The Nordic Corporate Governance Model – a European Model?, in* PERSPECTIVES IN COMPANY LAW AND FINANCIAL REGULATION 145 (Michel Tison, Hans de Wulf, Christoph van der Elst & Reinhard Steennot, eds. 2009); *see also* THE NORDIC CORPORATE GOVERNANCE MODEL 9 (Per Lekvall, ed., 2014).

[10] *See supra* note 9, *see also* ANDREW JOHNSTON, EC REGULATION OF CORPORATE GOVERNANCE 266, 280-287 (2009), Ulf Bernitz, *Mechanisms of Ownership Control and the Issue of Disproportionate Distribution of Power, in* COMPANY LAW AND ECONOMIC PROTECTIONISM 191 (Ulf Bernitz & Wolf-Georg Ringe, eds., 2010).

[11] *See* Bernitz, *supra* note 10, Rolf Skog, *The European Union's Proposed Takeover Directive, the "Breakthrough" Rule and the Swedish System of Dual Class Common Stock*, 45 SCANDINAVIAN STUDIES IN LAW 293 (2004), Rolf Skog, *Does Sweden Need a Mandatory Bid Rule?, A Critical Analysis* (SUERF Report, 1997), *available at* http://wvw.suerf.org/download/studies/study2.pdf.

[12] *See* Luca Enriques, *EC Company Law Directives and Regulations: How Trivial Are They?*, 27 U.PA.J. INT'L.ECON.L. 1 (2006).

[13] *See* Thomas Papadopoulos, *The Mandatory Provisions of the EU Takeover Bid Directive and Their Deficiencies*, 1 LFMR 525 (2007), Rolf Skog, *The Takeover Directive – an Endless Saga?*, 13 EUROPEAN BUSINESS L REV. 301 (2002).

At the same time, the importance of EU regulation has been increasing. As economies have become more integrated with increased globalization, there has been a need to find solutions for coordinating economic interaction among different economic and regulatory systems. Supranational political systems such as the EU provide one such solution – albeit with many challenges[14]. Overall, the EU has provided an alternative avenue to pursue an over-arching regulatory framework that can combine international standards with national differences[15]. The characteristics of the institutional structures at the EU level have facilitated policy making in select areas of policy, and circumvented national political processes and structural rigidities[16]. The role of the EU as a source for regulation – especially in relation to corporate governance - has further increased in the years following the financial crisis[17]. Even more recently, the Commission announced its goal to develop a closer capital markets union to enhance financing for European corporate enterprises[18]. Considering the close relationship between capital markets regulation and corporate governance, developing regulatory responses with respect to corporate governance at the EU level clearly remains an important pursuit.

Moreover, despite the criticism, it does not seem justified to renounce EU level regulatory initiatives as such. The EU can provide an avenue to circumvent entrenched regulatory models, and the possibility of EU intervention can prompt national regulatory reform. EU initiatives have increased the transparency and the comparability of regulatory solutions across the EU[19]. Also, some of the criticism of EU regulation may have been self-serving and intended to promote the interests of regionally prominent interest groups[20]. Different corporate governance systems have their own challenges related to the potential for abuse and supranational regulatory intervention may well have been justified from time to time. Even if EU regulation has been far from perfect, national regulation does not necessarily fare much better as domestic regulatory structures may be geared to promote the entrenched interests of politically dominant constituencies[21].

---

[14] *See* Masahiko Aoki, *The Japanese Firm as a System of Attributes: A Survey and Research Agenda, in* THE JAPANESE FIRM: THE SOURCES OF COMPETITIVE STRENGTH 11, 34-36 (Masahiko Aoki & Ronald Dore, eds., 1994); MASAHIKO AOKI, TOWARD A COMPARATIVE INSTITUTIONAL ANALYSIS 391 (2001); s*ee also* Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function, in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 128 (Jeffrey N. Gordon & Mark Roe, eds., 2004).

[15] Helen Wallace & William Wallace, *Overview: The European Union, Politics and Policy-Making*, in HANDBOOK OF EUROPEAN UNION POLITICS 339, 344 (Knud Erik Jorgensen, Mark A. Pollack & Ben Rosamond, eds., 2007).

[16] *Id.*

[17] Armour & Ringe (2011), *supra* note 1, at 40; *see also* Klaus Hopt, *Corporate Governance in Europe – A Critical Review of the European Commission's Initiatives on Corporate Law and Corporate Governance*, 12 N.Y.U. J.L. & BUS. 139 (2015).

[18] *See European Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Action Plan on Building a Capital Markets Union*, COM(2015) 468 final, (Sept. 30.2015).

[19] See Jean-Michel Josselin & Alain Marciano, *Introduction: The Economics of the Constitutional Moment in Europe, in* THE ECONOMICS OF HARMONIZING EUROPEAN LAW 1, 9 (Alain Marciano & Jean-Michel Josselin, eds., 2002).

[20] Guido Ferrarini & Geoffrey P. Miller, *A Simple Theory of Takeover Regulation in the United States and Europe* 15 (New York University Law and Economics Working Paper 197, 2009), *available at* http://lsr.nellco.org/nyu_lewp/197.

[21] *See* Lucian A. Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Governance and Ownership*, 52 STAN.L.REV. 127 (1999).

The legal strategies for regulatory intervention at the EU level and the design of EU regulation clearly remain challenging issues, as discussed above. There are a number of approaches to coordinate diverging regulatory systems, including harmonization and regulatory competition. The EU program of positive harmonization has been subject to much criticism in this regard. Commentators have questioned the extent to which it is appropriate to introduce uniform EU level corporate governance regulation, for example, considering the variation in corporate environments through the EU member states[22]. Instead of pursuing market integration through harmonization, some scholars argue that regulatory competition would be a superior way to develop EU corporate governance regulation[23]. The prerequisites for effective real-world regulatory competition have been debated, however. Regulation is only one factor affecting companies, and benefits from regulatory arbitrage in the field of corporate law or corporate governance may not be significant enough to cover costs of relocation, for example. Taxation has typically been a more dominant feature in this regard. It is also not clear whether EU member states would, in fact, have sufficient incentives to develop policies with the specific aim of attracting companies to re-establish in their jurisdictions. EU member states may lack the incentives to supply regulation tailored to attract incorporations[24]. Benefits may be limited, risky and long-term, while the investments required would be immediate and costly[25]. In the EU, considerable national lock-ins remain for corporations subject to a plethora of regulation varying from labor regulation to taxation, which hinder efficient cross-border establishment. Also, the differences in the institutional environments (including complementary institutional structures) do not necessarily facilitate an expedited process of regulatory competition. Altogether, there is some concern that the premises for regulatory competition in the EU are still incomplete, and cannot necessarily be relied on to provide a mechanism for EU wide regulatory development. Also, negative harmonization based on court rulings and interpretations of the EC Treaties may be too slow to support efficient market integration.

In this environment it remains important to identify problems related to EU harmonization and to better understand the dynamics of regulation and regulatory processes. This can contribute to the development of both the design of EU regulatory mechanisms and the regulatory processes for EU regulation. This dissertation seeks to contribute to this development by combining legal and political approaches to comparative corporate governance research.

II. Goals And Scope of the Study

A. Theme of Research

The goal of the study is to provide a basis for developing legal strategies for EU corporate governance regulation in light of the challenges of the (i) varied regulatory requirements of different corporate environments in the EU and (ii) the political dynamics of supranational corporate governance regulation. This requires a better awareness of the factors that affect (i) the impact and effectiveness of different legal strategies and regulatory mechanisms in different corporate environments and (ii) the political dynamics of EU policy-making with

[22] *See* Johnston (2009), *supra* note 10.
[23] *See* Enriques (2005), supra note 1, Enriques & Gatti (2006), *supra* note 1.
[24] *See* Johnston (2009), *supra* note 10, at 182-184.
[25] *Id.*

respect to corporate governance regulation. The study seeks to understand the environment for EU corporate governance regulation by studying select EU regulatory initiatives and the debates related to these initiatives. The study then focuses on how legal strategies can be developed at the EU level to better respond to the characteristics and the challenges of this environment.

The study is primarily concerned with the observation that EU regulation may have different and even contradictory effects across jurisdictions depending on the relevant institutional environment[26]. The question that arises is what institutional factors are relevant with respect to the effects of corporate governance regulation and how these can be taken into account in legal strategies. In this regard the study is largely based on a Nordic perspective and observations of Nordic corporate governance systems. The Nordic perspective is used as a tool to demonstrate the challenges of applying the same EU level regulation in a variety of institutional environments. A key argument of the study is that different legal strategies may be required to ensure that legal intervention has the desired effects in different institutional environments. This should be reflected in the choice of legal strategies and regulatory design at the EU level. Indeed, much of the criticism of EU regulatory initiatives has been targeted at how specific regulatory mechanisms have not been adapted to different models of corporate governance – including governance systems in the Nordic countries[27].

The other principal theme of the study relates to the corporate governance policies pursued at the EU level - as well as the underlying legislative dynamics. In this context the relevant research questions include, first, what the dynamics of legislative processes underlying EU level corporate governance regulation are, and second, what the prerequisites are to develop legal strategies at the EU level to better take into consideration the differing institutional landscape and the relevant political framework in the EU. The study seeks to understand the dynamics affecting the legislative processes underlying EU level corporate governance regulation. The study seeks to promote an increased understanding of how the characteristics and political dynamics of EU regulation can be taken into account in developing supranational legal strategies[28].

The study argues that the institutional and political dimensions of corporate governance are not sufficiently taken into account in the choice of legal strategies and in the design of regulatory mechanisms at the EU level. Moreover, the theoretical basis for developing EU corporate governance regulation has been insufficient – based in part on the lack of combining different approaches to corporate governance (including combining legal and political approaches). This has resulted in (i) an incomplete understanding of the basis for corporate governance regulation, (ii) increased political resistance to regulatory initiatives due to poor choice of legal strategies, and (iii) unintended consequences of EU regulatory intervention. The study argues that formal qualitative models should be developed to incorporate the institutional and political dimensions of corporate governance in the process of developing corporate governance regulation.

---

[26] Goergen, Martynova & Renneboog (2005), *supra* note 8; John C. Coates IV*, Ownership, Takeovers and EU Law: How Contestable Should EU Corporations Be?* 12 (ECGI Law Working Paper 11, 2003), *available at* http://ssrn.com/abstract=424720.

[27] Per Lekvall, *Foreword, in* THE NORDIC CORPORATE GOVERNANCE MODEL, *supra* note 9, at 9.

[28] *See* John Armour, Henry Hansmann & Reinier Kraakman, *Agency Problems and Legal Strategies, in* KRAAKMAN ET.AL., THE ANATOMY OF CORPORATE LAW 35 (2nd. ed., 2009).

The study is of topical interest as the EU Commission is taking new steps to develop corporate governance in the EU making it particularly relevant to consider corporate law issues in the prevailing institutional environment in Europe[29]. There has also been an emerging interest in whether concentrated ownership can provide a competitive monitoring structure and a basis for long term growth - at the same time there has been concern over decreasing engagement of shareholders in models with dispersed ownership[30]. The study is particularly interesting at a time when new regulatory initiatives are seen to result from the financial crisis, and when national interests[31] may be emerging that balance the drive for further opening the internal market with regard to the market for corporate control in the EU.

Regulatory initiatives related to "better regulation" have also emerged at national and EU levels over the past years. The EU has a stated aim of developing "better regulation for better results" so that policies are clearly set and communicated and pursued through effective and target regulatory initiatives[32]. The relevance of these types of programs can be questioned and can, in part, be seen as political rhetoric to address legitimacy concerns of the EU. Nevertheless, this study argues that there is room to increase the transparency of regulatory processes in the EU and to better understand the relationship between regulation and the institutional environment where it is applied. This can provide tools to develop the design of regulation to better meet stated policy goals in a varied institutional environment such as the EU.

B. DEVELOPING LEGAL STRATEGIES

Legal strategies for corporate governance have often been analysed with a focus on different national systems of corporate governance[33]. Legal intervention based on prescriptive rules and standards, often combined with disclosure obligations, is generally associated with efficient enforcement institutions, such as independent agencies and effective court systems. This type of intervention based on regulatory strategies may be called for when the affected constituencies are precluded from efficiently coordinating monitoring themselves – as is the case with dispersed shareholders, for example. Other strategies based on the ability of "principals" to exercise monitoring functions independently may be associated with less formal enforcement institutions. However, developing legal strategies in a supranational framework, such as the EU, provides for special challenges as the institutional environment

[29] *See* the Company Law Action Plan, *supra* note 4.
[30] *See European Commission, The EU Corporate Governance Framework, Green Paper, Brussels,COM(2011) 164 final* (Apr. 5, 2011) [hereinafter the "Corporate Governance Green Paper"]; *see also* Lynn Dallas, *Short-Termism, the Financial Crisis and Corporate Governance* (San Diego Legal Studies Paper No. 11-052, 2011).
[31] Italy, for example, having initially adopted no-frustration and break-through rules based on the Takeover Directive, has amended its takeover regulation after implementation to allow certain pre- and post-bid defences to be adopted by boards. *See* discussion in Paul Davies & Klaus Hopt, *Control Transactions*, in THE ANATOMY OF CORPORATE LAW, *supra* note 28, at 272. Germany, on the other hand, has introduced regulation requiring government consent for certain corporate acquisitions by foreign acquirers. See Sec. 7 (2) no. 5 Aussenwirtschaftsgesetz (AWG) - Foreign Trade and Payments Act and Aussenwirtschaftsverordnung (AWV) (Regulation Implementing the Foreign Trade and Payments Act). See also Jeffrey N. Gordon, *An American Perspective on Anti-takeover Laws in the EU*, in REFORMING COMPANY AND TAKEOVER LAW IN EUROPE 545-547 (Guido Ferrarini, Klaus Hopt, Jaap Winter, & Eddy Wymeersch, eds., 2004).
[32] *See Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Better Regulation for Better Results - An EU agenda*, COM (2015) 215 final.
[33] Armour, Hansmann & Kraakman (2009), *supra* note 28, at 39.

varies across affected jurisdictions. Where one strategy may be appropriate in some EU member states due to the structure of corporate ownership, for example, another strategy may be called for in other jurisdictions with a different corporate environment. The effects of EU level regulation differ across the affected jurisdictions depending on the relevant applicable market structures and the broader institutional environment. In some cases the effects have been contradictory to the stated goals of EU regulation[34]. The design of EU regulation and the choice of regulatory mechanisms are relevant in this regard, and may need to be tailored to different institutional environments.

Moreover, the EU political institutions and the political processes for EU regulation pose their own challenges for pursuing regulatory change at the EU level. Regulatory responses are the result of political processes and the efforts of affected constituencies pursuing their interest through the markets for regulation. The study recognizes that corporate law can be expected to reflect the institutional power of dominant corporate constituencies[35]. However, the EU framework has added considerable complexity to the political dynamic of regulatory development. The EU process has its own characteristics with respect to interest group input and political dynamics of the legislative process[36]. The EU political institutions provide an alternative and additional framework to national institutions with respect to interest group input and the regulatory markets. The agendas and alliances of affected constituencies and interest groups may differ across the EU creating a challenging political dynamic to be taken into account when considering feasible strategies for regulatory intervention at the EU level.

In summary, at the EU level it is not sufficient to address specific policy concerns within a given institutional setting. In fact, developing EU level legal strategies poses at least two different kinds of challenges that differ from regulatory intervention at the national level. First, the effects of EU level regulation vary depending on the institutional environment in different member states and, second, the political processes related to the enactment of EU regulation create a multilevel governance framework that affects how interest groups promote their agendas through regulatory intervention[37]. These factors must be taken into account also when considering the development of EU corporate governance regulation and different mechanisms for regulating control transactions.

The main focus of the study is to identify and assess key issues to be taken into account in developing legal strategies for EU level corporate governance and takeover regulation for an environment of concentrated ownership. For practical implications, the study looks to identify concrete problems in EU regulatory design with regard to corporate governance regulation. In this regard the study can form a basis for better design of EU corporate governance regulation. In a broader context, the study contributes towards a better understanding of developing regulatory strategies for supranational political systems and for complex and varied environments.

[34] *See* Coates (2003), *supra* note 26.

[35] John Armour, Henry Hansmann & Reinier Kraakman, *What is Corporate Law?, in* THE ANATOMY OF CORPORATE LAW, *supra* note 28, at 32.

[36] *See* SIMON HIX AND BJÖRN HÖYLAND, THE POLITICAL SYSTEM OF THE EUROPEAN UNION 12-16 (2011).

[37] See LIESBET HOOGHE & GARY MARKS, MULTI-LEVEL GOVERNANCE AND EUROPEAN INTEGRATION (2000).

C. EU CORPORATE GOVERNANCE AND TAKEOVER REGULATION

EU corporate governance regulation provides an interesting field for research with respect to the interaction between regulation and market structure. There have traditionally been significant differences in the structure of corporate ownership in the EU member states said to reflect basic differences in the structure of national economies referred to in the political economy literature as *varieties of capitalism*[38]. These differences can also be explained in terms of industrial history and path dependence[39]. The differences can be seen in corporate governance solutions that have evolved in different regions in Europe and the EU member states. Shareholder primacy, for example, has been much emphasized in the United Kingdom, whereas corporate governance solutions in Continental Europe are said to reflect a stakeholder model with an emphasis on balancing shareholder interests against those of other stakeholders, including employees. Corporate governance regulation, then, makes an interesting research topic for understanding the challenges of EU level regulatory initiatives.

One of the more controversial corporate governance initiatives at the EU level was the adoption of the Takeover Directive. The directive was adopted in 2004 after a long legislative process subject to intense political pressure and compromise[40]. While the Takeover Directive has contributed somewhat towards harmonizing the processes related to takeover bids across the EU, it has been criticized for not delivering the level playing field in corporate control set as its goal[41], and for not contributing to the development of a European market for corporate control[42]. It has been argued that instead of facilitating takeovers the mechanisms introduced in the directive in fact support further shareholder entrenchment specifically in the context of concentrated ownership[43]. Commentators frustrated at the level of political compromise in connection with the adoption of the directive have even argued the directive not to be worth the paper it was written on[44]. This study will look more closely at the Takeover Directive. Takeovers provide a corporate governance function as a management monitoring system and a framework for the transfer of corporate control. The potential for conflicts of interest in takeover situations is accentuated, while the corporate governance relationships include new elements with the introduction of external bidders[45]. Takeover regulation provides therefore an important subject (and an interesting proxy) for researching corporate governance models.

More recently, the EU Commission has introduced new regulatory initiatives in the field of corporate governance that have also been controversial. In 2011, the Commission published

---

[38] *See* DEBATING VARIETIES OF CAPITALISM (Bob Hancké, ed., 2009); and VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE 1 (Peter A. Hall & David Soskice eds., 2001).

[39] *See* Bebchuk & Roe (1999), *supra* note 21, MARK ROE, STRONG MANAGERS, WEAK OWNERS – THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994), MARK ROE, THE POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE: POLITICAL CONTEXT, CORPORATE IMPACT (2003).

[40] See *Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids*, Brussels, January 10, 2002, available at http://ec.europa.eu/internal_market/company/docs/takeoverbids/2002-01-hlg-report_en.pdf [hereinafter High Level Group Report]; see also Johnston (2009), *supra* note 10, at 268-280.

[41] *See* Paul Davies, Edmund-Philippe Schuster & Emilie Van de Walle de Ghelcke, *The Takeover Directive as a Protectionist Tool?* (ECGI Law Working Paper 141, 2010), *available at http://ssrn.com/abstract=1554616*.

[42] *See* Thomas Papadopoulos, *The Mandatory Provisions of the EU Takeover Bid Directive and Their Deficiencies*, 1 LFMR 525-533 (2007), *available at* http://ssrn.com/abstract=1088894 .

[43] *See* Coates (2003), *supra* note 26.

[44] *See* Vanessa Edwards, *The Directive on Takeover Bids – Not Worth the Paper It's Written On?,* 1 ECRF 416, 439 (2004).

[45] Paul Davies & Klaus Hopt (2009), *supra* note 31, at 225 - 229.

the Corporate Governance Green Paper and based on responses to the related consultation, published an action plan on company law and corporate governance in late 2012[46]. Many of the original initiatives, as well as the notion of an increase in EU level regulatory intervention in the field of corporate governance, have caused alarm among key corporate constituents in the EU member states[47]. The initiatives have been argued, among other, to decrease the competitiveness of publicly listed companies in the EU and consequently of the EU financial markets[48]. In responding to the initiatives market participants have emphasized that corporate governance issues should be regulated primarily at the national level and that the EU should limit its involvement in this field[49]. The regulatory process related to the Corporate Governance Green Paper and the Company Law Action Plan provide further information on the regulatory dynamics of EU corporate governance regulation, and will be discussed in this study, as will the key elements of the proposal to amend the Shareholder's Rights Directive that derive from the action plan.

Developing EU corporate governance regulation has been poignant especially as it relates to listed companies. Stock markets have of course provided an effective avenue for cross-border investments, and as the volumes of these investments have increased, the differences in the corporate governance systems of EU member states have become a topic of greater interest. Increasing the liquidity of the European capital markets has been closely related to the efforts to develop an internal market, and the recent EU level initiative to promote a capital markets union, the "CMU"[50], is a further indication of EU interests in this field. The corporate governance regulation of listed companies is of course closely related to these efforts[51], and has thus become an increasingly important topic for EU level regulatory initiatives[52]. In this study, therefore, corporate governance will be discussed specifically in the context of public corporations, i.e. companies with shares traded on a regulated market in the EU. Indeed, some EU corporate governance initiatives have specifically addressed listed companies only[53]. However, it can be noted that corporate governance often relates to matters of corporate law, and in many cases there is little difference between a listed and non-listed company for the purposes of corporate law. Consequently the importance of EU level regulation will necessarily increase also with respect to non-listed companies as well.

The study focuses on certain key EU level regulatory initiatives that address corporate governance relationships. The Takeover Directive and the Company Law Action Plan, including the proposed amendments to the Shareholder's Rights Directive in particular, will be used as examples to describe the dynamics of EU regulation. The study will focus on specific provisions that are of particular interest vis-à-vis the relative position of different corporate constituencies – these include break-through rules and provisions on mandatory tender offers, and regulation of related party transactions, for example. This approach serves

[46] *See* the Corporate Governance Green Paper, *supra* note 30.
[47] Miles Johnson, *Europe: EU Paper Raises Doubts over Shareholder Model*, Financial Times, October 6, 2010.
[48] *See* Swedish Corporate Governance Board, *Views on the EU Green Paper on the Corporate Governance Framework*, 19.7.2011, *available at* http://www.bolagsstyrning.se/media/53853/views%20on%20eu%20cg%20framework%20from%20the%20swedish%20cg%20board%202011-07-19.pdf.
[49] Enriques (2005), *supra* note 1.
[50] *Supra* note 18.
[51] *Id.* at 24.
[52] *See, for example,* the directive 2006/46/EC on corporate governance statements and directive 2007/36/EC on the rights of shareholders. *See also* the Corporate Governance Green Paper.
[53] Most evidently the Takeover Directive.

the purpose of the study – i.e. to understand the dynamics of EU corporate governance regulation that affects key corporate constituencies.

D. CONCENTRATED OWNERSHIP AND THE NORDIC CORPORATE GOVERNANCE ENVIRONMENT

The study deals with how EU regulation is adapted to the varied institutional environments in the EU. One of the key differences between different types of economies in the EU is the structure of corporate ownership. The interaction between corporate ownership structure and corporate governance regulation is therefore of some interest for the study. On a general level, certain key distinctions in ownership models in the EU exist between the UK and Continental Europe, for example. Ownership in listed companies in the UK is typically widely dispersed with a strong institutional shareholder base[54]. In Continental Europe and the Nordic region, on the other hand, listed companies may have a single large shareholder or shareholder block with a controlling stake. Companies can also have a blocking minority shareholder who may not have an absolute majority, but at least controls a significant block of the shares and votes in the company[55]. The level of ownership concentration in EU member states has decreased somewhat over the past decade but still remains high in many regions in the EU[56]. In the Nordic region, it is reported that 62 percent of listed companies have at least one shareholder with over 20 percent of the votes and 21 percent of the companies have a shareholder with over 50 percent of the votes[57].

Both concentrated ownership and control enhancing mechanisms remain important features among publicly traded corporations in the EU[58]. These features raise specific regulatory concerns in relation to the relationship between controlling and minority shareholders as well as to the efficiency of corporate monitoring mechanisms[59]. At the EU level there has also been concern that the structures as such are an impediment to the development of active capital markets in the EU[60] and consequently even to economic growth[61]. However, even though concentrated ownership and control enhancing mechanisms remain common after

[54] *See* Mara Faccio & Larry H.P. Lang, *The Ultimate Ownership of Western European Corporations,* 65 JFE 365, (2002).
[55] *See* Marco Becht, *Reciprocity in Takeovers* (ECGI – Law Working Paper No. 14/2003), *available at* http://ssrn.com/abstract=463003.
[56] *See* Christoph van der Elst, *Shareholder Mobility in Five European Countries* (ECGI - Law Working Paper 104/2008), *available at* http://ssrn.com/abstract=1123108 or http://dx.doi.org/10.2139/ssrn.1123108
[57] THE NORDIC CORPORATE GOVERNANCE MODEL, *supra* note 9, at 50, 280-284.
[58] *See* Faccio & Lang (2002), *supra* note 54; *see also* Shearman & Sterling, *Proportionality Between Ownership and Control in EU Listed Companies* (External Study Commissioned by the European Commission, May 18, 2007, Open Call for Tender No MARKT/2006/15/F), *available at* ec.europa.eu/internal_market/company/docs/shareholders/study/final_report_en.pdf [hereinafter EU Proportionality Report].
[59] *See* Lucian A. Bebchuk, Reinier Kraakman & George Triantis, *Stock Pyramids, Cross-Ownership and Dual Class Equity: The Creation and Agency Costs of Separating Control from Cash Flow Rights* 12 (Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series 249, 1999), *available at* http://lsr.nellco.org/harvard_olin/249: "The CMS ["controlling minority structure"] lacks the principal mechanisms that limit agency costs in other ownership structures. Unlike the DO ["dispersed ownership"] structures, where controlling management may have little equity but can be displaced, the controllers of CMS companies face neither proxy contents nor hostile takeovers".
[60] *See* High Level Group Report*, supra* note 40.
[61] Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Schleifer & Robert Vishny, *Investor Protection and Corporate Governance*, 58 JSE, 3-27 (2000) [hereinafter La Porta et al. (2000)].

years of market integration it is not clear that these characteristics have been sufficiently taken into account in EU corporate governance regulation[62]. In fact, the nature of the EU initiatives introduced to address these features suggests that concentrated ownership and control enhancing mechanisms have to some extent been deemed problematic *per se*, and that these structures should be discouraged through regulatory intervention[63]. However, empirical studies suggest that it is unclear that concentrated ownership is an inefficient form of corporate ownership or that control enhancing structures necessarily provide an impediment for the development of a market for corporate control[64]. In fact, empirical studies in the EU report a relationship between high levels of corporate performance and ownership concentration[65] - and there are jurisdictions in the EU that report both high levels of concentrated ownership and active takeover markets[66]. Nor is it clear that regulatory intervention by itself would lead to the increase of dispersed ownership[67] or indeed that other forms of corporate ownership would be superior in the EU markets. Given the prevalence of concentrated ownership and the entrenchment of control structures it seems fruitful to focus on developing regulation that recognizes these features while addressing related regulatory concerns.

The study will consider, in particular, the dynamic of takeovers and EU takeover regulation in an environment of concentrated ownership. For practical purposes, observations will be based on experiences in the Nordic region. The governance models adopted in the Nordic countries have gained increasing interest internationally[68]. Following the financial crisis there have been concerns related to the perceived "short-termism" of institutional shareholders and the status of shareholders more generally in corporate governance. It has been argued that corporate governance models are failing due to inadequate monitoring by dispersed shareholders[69]. As a result there has been an emerging interest in the role of large shareholders in developing better corporate governance solutions for publicly traded corporations[70]. The corporate governance models in the Nordic countries, where corporate ownership remains somewhat concentrated but where private benefits of control are reportedly relatively low, have therefore been of interest in the international corporate

[62] *See* Gerard Hertig & Joseph McCahery, Joseph A., *Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition?* (ECGI Law Working Paper No. 12/2003), *available at* http://ssrn.com/abstract=438431.
[63] *See* Erik Berglöf, & Mark Burkart, *European Takeover Regulation*, 18 ECON. POL. 171 (2003), *available at* http://www.jstor.org/stable/1344656.
[64] *See* Harold Demsetz & Kenneth Lehn, *The Structure of Corporate Ownership: Causes and Consequences*, 93 J. OF POL. EC. 1155 (1985); Torben Pedersen & Steen Thomsen, *Ownership Structure and Value of the Largest European Firms: The Importance of Owner Identity*, 7 J. OF MANAGEMENT AND GOVERNANCE 27 (2003); Ann-Kristin Achleitner, André Betzer, Marc Goergen & Bastian Hinterramskogler, *Private Equity Acquisition of Continental European Firms - The Impact of Ownership and Control on the Likelihood on Being Taken Private* (Working paper, June 2010) *available at* http://ssrn.com/abstract=1319836.
[65] *See* Pedersen & Thomsen (2003), *supra* note 64.
[66] Most notably this is the case in Sweden. See Jonas Agnblad, Erik Berglöf, Peter Högfeldt & Helena Svancar, *Ownership and Control in Sweden: Strong Owners, Weak Minorities and Social Control, in* THE CONTROL OF CORPORATE EUROPE (Fabrizio Barca & Marco Becht, eds., 2001).
[67] *See* Magnus Henrekson & Ulf Jakobsson, *The Swedish Corporate Governance Model: Convergence, Persistence or Decline?* 20 CORPORATE GOVERNANCE: AN INTERNATIONAL REVIEW 212 (2012).
[68] Richard Milne, *Model Management*, Financial Times, March 21, 2013, at 5; *see also* THE NORDIC CORPORATE GOVERNANCE MODEL, *supra* note 9, at 9 and 13-14.
[69] See Dallas (2011), *supra* note 30.
[70] *Report of the Reflection Group on the Future of EU Company Law* (April 5, 2011), *available at* http://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en.pdf [hereinafter Reflection Group Report (2012)], *and* The Corporate Governance Green Paper, *supra* note 30.

governance debate. Nordic corporate governance has at times even been seen as an "ideal model"[71]. However, rather than accepting such statements at face value, this study will consider the development of corporate governance in the Nordic region from a historical and political perspective to highlight the political aspects of corporate governance on a national and regional level. This perspective provides additional insight into the complexity of developing legal strategies for corporate governance regulation.

Concentrated ownership and corporate governance in a Nordic environment will be used as a case study and provides a perspective from which EU regulation is observed for the purposes of the study. It has been observed that EU takeover regulation has different effects in the member states depending on the applicable prevalent structure of corporate ownership that may be in contradiction to the stated goals of the Takeover Directive[72]. It has been argued, for example, that the regulatory mechanisms chosen by the EU Commission to address issues arising in the context of concentrated ownership and control enhancing structures have been flawed as such[73]. This criticism was vocal also in the Nordic region[74]. In many respects the Takeover Directive transplanted regulatory solutions from the United Kingdom - with largely a dispersed ownership structure and active takeover markets - to apply throughout the EU member states largely dominated by an environment of concentrated corporate ownership. In this respect regulation has not been tailored to the broader national institutional environment in most member states, and the effects of regulatory intervention can be expected to vary[75]. The critique of the EU Takeover Directive in this regard is based on the recognition that a uniform regulatory framework may not be appropriate throughout the varied structures of corporate ownership in the EU member states. It has been argued, for example, that "similar regulatory changes may have very different effects within different corporate governance systems. For example, while in some countries the adoption of a specific takeover rule may lead toward more dispersed ownership, in others it may further reinforce the blockholder-based system."[76] These factors are important to take into consideration when choosing legal strategies for corporate governance regulation at the EU level.

III. CORPORATE GOVERNANCE IN THE EU CONTEXT

The theme of the study is focused on corporate governance and the regulation thereof in the EU context. Given that the corporate environments may vary among the EU member states it is particularly relevant to discuss the concept and definition of corporate governance, and to set out the theoretical framework for how this study understands and approaches corporate governance and corporate governance regulation.

A. DEFINING CORPORATE GOVERNANCE

The definition of corporate governance has been subject to much debate, and numerous alternatives have been offered by scholars with different approaches to corporate governance

[71] *See* Richard Milne (2013), *supra* note 68; JESPER LAU HANSEN, NORDIC COMPANY LAW – THE REGULATION OF PUBLIC COMPANIES IN DENMARK, FINLAND, NORWAY AND SWEDEN 1 (2003).
[72] *See* Coates (2003), *supra* note 26.
[73] *See* Davies, Schuster & van der Walle de Ghelcke (2010), *supra* note 41.
[74] *See* Rolf Skog (1997), *supra* note 11.
[75] *See* Goergen, Martynova and Renneboog (2005), *supra* note 8.
[76] *Id.* at 29.

research[77]. For the purposes of this study it is important to understand corporate governance in terms that recognize the legal, economic and political aspects of corporate governance. Some definitions anchored in agency-theory may neglect the external aspects of corporate governance, while purely political approaches sometimes fail to recognize the requirements of competitiveness and economic performance.

In its simplest form corporate governance can be understood in an organizational context as "the system by which companies are directed and controlled"[78] with the aim of reducing transaction costs. Similarly, corporate law could be viewed as a default framework for the legal organization of business enterprise[79]. The function of corporate governance would be to address the collective action problems of various corporate claimholders and to reduce "the scope for value-reducing forms of opportunism among different constituencies"[80].

However, corporate governance is not only related to the organizational aspects of enterprise. The distributional and re-distributional aspects of corporate governance are a significant factor in this regard. The basis for how the revenue from the enterprise is distributed will have an effect on the willingness of corporate constituencies to make investments in the corporate enterprise. In this respect the definition by Shleifer & Vishny provides that "corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment"[81]. Shleifer and Vishny emphasize that production capital is actually specified so that it is committed to the enterprise (resulting in sunk costs). As different constituents consider firm-specific investments of capital or labor resulting in such costs, there must be sufficient assurance that they will be repaid. Corporate governance mechanisms are intended to provide that assurance[82]. Pursuant to the definition above, the goal of the corporate governance mechanisms is to provide a basis for an optimal balance in the terms and conditions of different types of contributions of production capital (equity, debt, labor etc.) from time to time. The Shleifer & Vishny definition suggests that corporate governance arrangements are much like contractual arrangements or covenants that are negotiated among the parties and affected by the risks and returns involved. This approach is also linked to the principal-agent theory of the firm.

It is well established, however, that corporate governance is a more complex phenomenon not easily defined based on a purely contractual approach. This is particularly difficult where entrepreneurial aspects are involved and there is disagreement on the potential levels of future cash-flows. At best, the theories related to costs of contracting suggest that the implicit contracts underlying the relationships between corporate constituents are incomplete[83].

[77] *See* OLIVER WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM (1985), Andrei Schleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. OF FIN. 737 (1997), Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VIRGINIA L.R. 247 (1999), Mary O'Sullivan, *Corporate Governance and Globalization*, 570 ANNALS OF THE AMERICAN ACADEMY OF POLITICAL AND SOCIAL SCIENCE 153 (2000), *and* Ruth V. Aguilera & Gregory Jackson, *The Cross-National Diversity of Corporate Governance: Dimensions and Determinants*, 28 ACADEMY OF MANAGEMENT REVIEW 447 (2003).
[78] *Report of the Committee on the Financial Aspects of Corporate Governance*, 1992, at 2.5, *available at* http://www.ecgi.org/codes/documents/cadbury.pdf.
[79] Armour, Hansmann & Kraakman (2009), *supra* note 35, at 2.
[80] *Id.*
[81] Shleifer & Vishny (1997), *supra* note 77, at 737.
[82] *Id.* at 738.
[83] *See* Philippe Aghion & Patrick Bolton, *An Incomplete Contracts Approach to Financial Contracting*, 59 R. ECON. STUDIES 473 (1992).

Corporate governance provides the means and mechanisms by which potential conflicts of interest among different corporate constituencies are resolved. It is important to recognize, however, that the dynamics of corporate governance can change. Corporate constituents can seek to renegotiate these contracts if their bargaining power increases over time with each party seeking to increase its stake from the income of the enterprise[84].

A broader version of the definition of corporate governance has been provided by Zingales, whereby corporate governance is the "set of conditions that shapes the ex post bargaining over the quasi rents generated by a firm"[85]. Zingales emphasizes the incompleteness of contracts and recognizes the interests of all parties that are mutually specialized and have made firm-specific investments, i.e. shareholders, employees, suppliers and customers[86]. As assets are specialized their value outside of that context decreases. This has important implications for the efficient allocation of control rights. Zingales argues that, as a result, residual rights of control should be allocated to a "group of agents who need to protect their investment against ex post expropriation, but who have little control over how much the asset is specialized"[87]. This approach has important implications for corporate governance mechanisms. Zingales sees that governance mechanisms, including allocation of ownership, financial structure, organizational structure, product market competition and takeovers, can be seen as institutions affecting the process of how quasi rents are distributed. This suggests that the firm is a complex structure[88] and expands corporate governance to cover a broader range of norms and circumstances. The relationships between corporate constituencies are also not defined in hierarchical terms, but rather in terms of their relative dependency on each other. A further aspect is that these relationships are not in an equilibrium[89] but evolve with technological, political and institutional developments. Thus the group of agents in need of protection for firm-specific investments will change over time.

Other Approaches

Other approaches to corporate governance have also been advocated[90]. Stakeholder theory, for example, emphasizes that also other constituencies than shareholders make firm-specific investments and should have residual claims and appropriate control rights[91]. Corporate governance is seen as a broader framework as "the whole set of legal, cultural and institutional arrangements that determine what publicly traded corporations can do, who controls them, how control is exercised, and how the risk and returns from the activities they undertake are allocated"[92]. In this regard stakeholder theory is based on a more open system

---

[84] Manuel A. Utset, *Towards a Bargaining Theory of the Firm*, 80 CORNELL L.REV. 540, 609 (1995).
[85] *See* Luigi Zingales, *Corporate Governance* 16 (NBER Working Paper 6309, 1997), *available at* http://www.nber.org/papers/w6309 .
[86] *Id.* at 5.
[87] *Id.* at 13.
[88] *See* Bruno Deffains & Dominique M. Demougin, *Governance: Who Controls Matters* (SFB 649 Discussion Paper No 53, 2006), *available at* http://hdl.handle.net/10419/25136.
[89] MASAHIKO AOKI, CORPORATIONS IN EMERGING DIVERSITY: COGNITION, GOVERNANCE AND INSTITUTIONS 13-14 (2010).
[90] *See* Johnston, *supra* note 10.
[91] *See* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VIRGINIA L.R. 247 (1999).
[92] MARGARET M. BLAIR, OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY 3 (1995).

perspective than definitions anchored in agency-theory alone[93]. Stakeholder theory is based on a different premise of cooperation among the participants in the business effort emphasizing the role of corporate organs, such as the board, as mediators between the differing interests of these participants[94]. Stakeholder theory also broadens the notion of efficiency in recognizing the possibly differing views of corporate constituencies in this regard. It also recognizes the role of corporations in society and the legitimacy of external corporate governance. The corporation is not only seen as a theoretical structure, but as a legally defined independent entity. As such, a corporation can legitimately be expected to promote broader interests than merely those of shareholders. However, it has been argued that stakeholder theory does not necessarily provide help in guiding managerial practice[95], or in how to mediate among conflicting priorities. The theory has also been said not to recognize the cleavages within different constituencies whereby it is increasingly difficult to identify the interests of those constituencies[96].

Corporate Governance as a Framework for Bargaining

To define and understand corporate governance it is important to revisit the definition of the firm, and the characteristics of the corporation. Agency theory provides a basis for understanding the relationships between different actors involved in economic activity[97]. The idealized "firm" has been viewed as a "nexus of contracts" for corporate constituencies when regulating agency relationships in relation to a business enterprise[98]. In their approach Jensen & Meckling view the "firm" as a legal fiction that provides the axis for contractually arranging the conflicting objectives of these actors for the purposes of economic activity[99]. While agency theory has provided major contributions towards the theory of the firm, it has been supplemented by other approaches, including transaction cost economics and the theory of property-rights. Scholars have argued that while agency theory provides a framework for understanding the problems related to the relationships between corporate constituencies, it does not fully explain the financial structure of the corporation. Hart points out, for example, that in applying agency theory in the corporate context the main focus seems to be on monitoring and aligning the interests of the agents with those of principals while there seems to be less focus on explaining the financial structure of the corporation[100]. Williamson has emphasized the relationship between the structure of corporate finance and governance so that the type of financial instrument and resulting governance system should be based on the characteristics of the specific project or transaction[101].

---

[93] See Ruth V. Aguilera, Igor Filatotchev, Howard Gospel & Gregory Jackson, *An Organizational Approach to Comparative Corporate Governance: Costs, Contingencies, and Complementarities*, 19 ORGANIZATION SCIENCE 475 (2008).
[94] Blair & Stout, *supra* note 91, at 253-254.
[95] *See* Steve Letza, Xiuping Sun & James Kirkbide, *Shareholding Versus Stakeholding: a Critical Review of Corporate Governance*, 12 CORPORATE GOVERNANCE: AN INTERNATIONAL REVIEW, 242, 255 (2004)
[96] *Id.*
[97] *See* Michael Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownershup Structure*, 3 JFE 305 (1976).
[98] *Id.*
[99] *Id.* at 314.
[100] Oliver Hart, *Financial Contracting* 7 and 9 (NBER Working Paper 8285, 2001) *available at* http://www.nber.org/papers/w8285.
[101] *See* Williamson (1985), *supra* note 77.

Importantly, it is also possible to approach the corporation and corporate governance as a framework for recurring bargaining among self-interested actors with varied interests who can obtain benefits from mutual cooperation[102]. This approach has its origins in game theory - but applied in a less-stylized environment with multiple parties and an unstable environment[103]. Bargaining occurs in, and is affected by, the broader institutional environment, involving market institutions and processes, the industrial and political environment and formal and social norms[104]. It has been argued that "(i)n comparison with the principal-agent theory, a model that puts the bargaining power in the centre is able to give a more comprehensive picture of the reality of the firm"[105]. This approach recognizes that governance of the corporation does not occur in a vacuum, and is affected by the relevant institutional environment that participants interact with, and based on which participants can also form coalitions for increased bargaining power[106]. According to Aoki, corporations and corporate constituencies, investors, management and employees, "are all important players in the political-exchange game, individually and collectively, contributing to the shaping of the political state"[107]. Bargaining can take the form of explicit or implicit contracts that parties may seek to renegotiate from time to time as their relative bargaining power evolves. The relative bargaining power among the corporate constituencies can change as a result of technological or industrial changes, for example, or through political developments and the introduction of new regulation. Bargaining, however, does not need to be direct and corporate constituencies can affect the internal relationships through the political system, for example. Importantly, this approach recognizes the legal and economic aspects of corporate governance, but incorporates the political aspects of corporate governance to the definition as well.

A relevant prerequisite for bargaining is the fact that contracts are necessarily incomplete, as discussed above, and it is generally not possible to fully regulate the relationships among corporate constituencies *ex ante*. When an investor has made a significant firm-specific investment (be it a shareholder, debt holder, manager or employee) it is difficult to withdraw the investment and it becomes less liquid. Once an equity investment is made, for example, it may not be possible to withdraw it and the investor is dependent on the continued performance of other constituencies. Similarly, an employee will be more dependent on the specific corporation once the employee has invested in firm-specific skills that may be difficult to take elsewhere. Other constituencies may look to take advantage of this and attempt to renegotiate the terms of their respective investments as their relative bargaining power changes. Investors will be aware of this risk, of course, and require *ex ante* guarantees to protect their initial investment[108]. However, as contracts are necessarily incomplete (and as

---

[102] *See* Aoki (2001), *supra* note 14, John C. Coffee, *Unstable Coalitions: Corporate Governance as a Multi-Player Game*, 78 GEO.L.J. 1495 1989-1990 and Utset, *supra* note 84.
[103] Coffee (1989-1990), *supra* note 102, at 1497.
[104] Masahiko Aoki & Gregory Jackson, *Understanding an Emergent Diversity of Corporate Governance and Organizational Architecture: An Essentiality-Based Analysis* 3 (SIEPR Discussion Paper 07-19, 2007), *available at* http://www-siepr.stanford.edu/repec/sip/07-019.pdf.
[105] Peter Nobel, *Stakeholders and the legal Theory of the Corporation*, in PERSPECTIVES IN COMPANY LAW AND FINANCIAL REGULATION, *supra* note 9, at 165, 176 - 179.
[106] See Aoki (2001), *supra* note 14, at 287-291; Coffee, *supra* note 102; *see also* PETER GOUREVITCH & JAMES SHINN, POLITICAL POWER AND CORPORATE CONTROL (2005).
[107] Aoki (2010), *supra* note 89, at 80.
[108] *See* Zingales (1997), *supra* note 85.

the alternatives available to the investors will likely have the same characteristics in an environment of incomplete contracts) there will be room for such renegotiations[109].

The structure of corporate finance and the corporate governance framework provide for the building blocks for bargaining. In this context, the corporation and corporate finance can be approached from the perspective of financial contracting[110]. In simple terms financial contracting in the corporate context can be seen as the understanding between the entrepreneur with an idea but no funds and the investor with funds but no idea[111]. The structure of corporate finance and the corporate governance of the corporation are the result of bargaining between these actors. In financial contracting theory the entrepreneur negotiates cash flow and governance rights with the providers of financing[112]. Entrepreneurs and investors can agree on the allocation of control rights and cash-flow rights with the aim of finding the best outcome to meet the specific requirements and priorities of each party. The different priorities of the actors and their relative valuation of control and cash-flow rights provide a basis for the bargaining over how cash-flow and governance rights are allocated between them. As discussed, different types of financial instruments, i.e. equity, debt and convertibles, are the basic the building blocks of corporate finance and corporate governance[113]. The structure of corporate finance sets the framework for ex-post bargaining over control. Debt-financing generally allows the entrepreneur to maintain control, for example. However, higher levels of debt increase the risk of default with the result, typically, that control will be passed on to the investors. Equity-financing, on the other hand, generally provides control to the investors. Financial instruments with contingent control rights, such as convertible debt, provide a further model of allocating governance rights in that control is transferred upon a triggering event typically linked to the performance of the enterprise.

Corporate governance can thus be approached as a broad framework for on-going bargaining[114] among corporate constituencies over the terms of corporate finance. Corporate governance regulation, then, covers a broader scope of regulation than provisions in corporate law that directly apply to the corporate rights and obligations of stakeholders and include, for example, tax laws, employee regulation and contract law. The regulation of legal institutions, such as commercial courts and agencies, are also relevant, as enforcement mechanisms are a key factor in legal strategies related to corporate governance. Finally, corporate governance cannot be understood without reference to the economic and political systems that create the framework for bargaining for the relevant constituencies. In fact, a political perspective to corporate governance can be seen to be aligned with defining corporate governance in terms of bargaining by independent constituencies who have different means to coordinate amongst themselves and to promote their interests in relation to other corporate constituencies. The approach outlined here therefore provides for a meaningful basis for this study overall.

---

[109] *Id.* at 3.
[110] *See* OLIVER HART, FIRMS, CONTRACTS AND FINANCIAL STRUCTURE (1995).
[111] Hart (2001), *supra* note 100, at 1.
[112] *Id.* at 1-2, 10-12; see also Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision,* 125 YALE L.J. 560 (2013).
[113] *See* Hart (2001), *supra* note 100.
[114] Aoki (2001), *supra* note 14, Nobel (2009), *supra* note 105.

B. THE POLITICAL CONTEXT OF CORPORATE GOVERNANCE

Regulation cannot be studied in isolation from economics and political systems. It is important to recognize that the corporation and the key corporate constituencies (shareholders, managers, and employees) do not operate in a vacuum. The nexus of contracts approach, for example, emphasizes the relationships among key constituents but may neglect how the institutional and political environment affects and interacts with the corporation and these constituencies – with redistributive effects. Politics can influence the loyalties and the relationships among corporate constituencies[115]. The regulation of corporations, including corporate governance, can be expected to reflect the interests of politically dominant constituencies[116]. This study recognizes that a broader range of stakeholders may have considerable interests and influence on the corporation and on the distribution of corporate revenues, and that the political aspects of corporate governance should not be underestimated.

At the same time, political approaches to corporate governance have not always provided normative guidance. Merely pointing out the political background of regulatory outcomes does not necessarily provide normative guidance for developing regulation. The economic and legal aspects of corporate governance are of paramount importance, and regulation can have a significant effect on competitiveness and economic performance, and not only on the distribution of revenue from economic enterprise (i.e. corporate governance is not a zero-sum game). In developing regulatory policy it is important to understand the political aspects of regulation, while recognizing the importance of economic performance[117].

A number of political explanations have been provided for the relationship between corporate ownership and corporate governance models on the one hand and political structures on the other hand[118]. The studies emphasize that both industrial history[119] and the structure of political processes[120] are important factors in understanding the development of corporate governance models. The political economy of corporate governance systems sets a framework for the development of corporate governance regulation. It helps to explain the current status of regulation and provides a background against which to consider feasible developments.

Political Systems and Corporate Governance

The development of industrial and market structures has been understood to have a significant effect on the development of corporate ownership and corporate governance. Corporate

---

[115] Ruth V. Aguilera & Gregory Jackson, *Comparative and International Corporate Governance*, 4 THE ACADEMY OF MANAGEMENT ANNALS 485, 513 (2010).

[116] ROGER M. BARKER, CORPORATE GOVERNANCE, COMPETITION AND POLITICAL PARTIES, EXPLAINING CORPORATE GOVERNANCE CHANGES IN EUROPE 77 (2010).

[117] It has also been argued that the basis of economic systems are political as such; yet such choices can have very grave consequences, as discussed by Douglass C. North; *see* DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE (1990).

[118] *See* Gourevitch & Shinn (2005), *supra* note 106, Marco Pagano & Paolo F. Volpin, *The Political Economy of Corporate Governance*, 95 AMERICAN ECON. REV., 1005 (2005), Enrico C. Perotti & Ernst-Ludwig von Thadden, *The Political Economy of Corporate Control and Labor Rents*, 114 J. OF POL. ECON. 145 (2006), Roe (2003), *supra* note 39.

[119] *See* Roe (2003), *supra* note 39, *and* Peter Högfeldt, *The History and Politics of Corporate Ownership in Sweden*, *in* A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS 517, 518-522 (Randall K. Morck, ed., 2005).

[120] *See* Perotti & von Thadden (2006), supra note 118.

governance systems will be developed so that they are adapted to their industrial and market environments. Markets with a prevalence of heavy industry will likely have different structures of corporate ownership, finance and corporate governance than markets dominated by trade or knowledge-based technologies, for example. The financing needs and the dynamics of the relationships among key corporate constituencies are likely to be quite different in the respective environments resulting in the emergence of different corporate finance and corporate governance models. Different solutions for addressing the same corporate governance concerns may evolve in different institutional environments. Complementary institutions adapted to a specific institutional environment will then develop to support the existing corporate governance framework[121]. The example often provided in this context is how the monitoring of management can be organized by different means, such as by controlling shareholders, financial institutions or market based solutions (the markets for corporate control or incentive programs)[122]. The monitoring system with rules and regulations then develops based on these different mechanisms.

In this context concentrated ownership has been seen to reflect the effects of the broader institutional environment. Roe mentions Germany, Italy and Sweden as examples of EU member states with a political and institutional environment that supports concentrated ownership[123]. Roe argues, for example, that in countries with strong labor institutions there is likely to be pressure for more corporate governance institutions that favor employees and less for institutions that support the interests of shareholders[124]. Companies are likely to be encouraged to expand to secure employment even at the cost of profitability, for example, and to avoid down-sizing as well as not to take disruptive risks[125]. In this environment the institutions needed for dispersed ownership to flourish are not present, whereas a controlling shareholder, on the other hand, would be in a better position, in relative terms, to bargain over surplus and to resist political pressures[126].

Other political economy explanations point out that in states with concentrated ownership a political majority with fewer financial incentives (and more labor-oriented financial interests) may oppose a market based system related to higher risk taking[127]. The outcome of the political system in this environment can be expected to favor large shareholders and labor at the cost of smaller investors and will support complementary governance structures - much of which can be observed in EU member states with concentrated ownership. The effect of incumbent industrial and financial interest groups on the development of financial systems based on their interest to restrain competition has also been emphasized[128]. Rajan and Zingales argue that it is in the incumbents' interest to restrict financial development and the openness of the economy to disallow competitors to emerge. With globalization their impact

[121] *See Aoki (2001), supra* note 14, at 300-305.
[122] Marco Becht, Patrick Bolton & Ailsa Röell, *Corporate Governance and Control* 1 (ECGI Finance Working Paper No 02, 2002, updated as of August 2005) *available at* http://ssrn.com/abstract_id=343461
[123] *See* Mark Roe, *The Institutions of Corporate Governance* 18 (Harvard Law School, John M. Olin Center's Program on Corporate Governance Discussion Paper 488, 2004), *available at* http:/www.law.harvard.edu/programs/olin_center/papers/pdf/Roe_488.pdf.
[124] *Id.* at 18.
[125] *Id.* at 18-19.
[126] *Id.* at 19.
[127] *See* Enrico C. Perotti & Ernst-Ludwig von Thadden, *The Political Economy of Dominant Investors* (Tinbergen Institute Discussion Paper 2004-091/2), *available at* http://dare.uva.nl/document/5462.
[128] *See* Raghuram G. Rajan & Luigi Zingales, *The Great Reversals: The Politics of Financial Development in the Twentieth Century*, 69 J. OF FIN. ECON. 5 (2003).

on financial markets has decreased resulting in an increase in financial development and market based corporate governance institutions[129].

Path Dependence

It has been emphasized that the development of corporate governance is path dependent as the development of new institutions is based on the existing institutional environment. Once a given structure has been established, it is likely to be reinforced as complementary institutions develop[130]. However, the development may not always lead to the most optimal outcome in the prevailing environment[131]. Sunk costs, externalities and complementarities caused by initial choices of governance structure increase the cost of choosing alternative structures[132]. Existing structures may also persist due to rent-seeking by parties empowered by the initial structure. The regulatory framework can be seen as a complementary institution that recognizes and reinforces certain ownership structures both due to efficiency and rent-seeking.

In the "varieties of capitalism" debate in political science[133] it is argued that economies can enhance their competitiveness by specialization; i.e. by taking advantage of the relative benefits of the type of economy it has. This argument suggests that the characteristics of an economy may strengthen as institutions develop that complement the system in question. This argument assumes that the basis and competitiveness of a particular "variety" is stable and sustainable. With globalization and technological innovations the basis for an economic model may change, so that different models of governance are required for retaining competitiveness. The question is whether the "varieties of capitalism" debate can in fact be defined more accurately in terms of path dependence where a given "variety" reflects a particular point in the specific development path of an economy. As economies and political systems develop complimentary institutions emerge and a corporate governance system will develop with appropriate political coalitions and regulatory and governance mechanisms that reflect the interests of the politically dominant groups – i.e. different "varieties of capitalism". Path dependence suggests that the system is likely to be entrenched, and deviation from the path that has developed becomes increasingly costly and difficult.

Political Coalitions and Governance Outcomes

The shareholders, management and employees of a corporation are typically identified as the main corporate constituencies. Different corporate constituencies will seek to renegotiate the contracts as their bargaining power increases. Bargaining is likely to occur when constituencies have made firm-specific investments and are committed with significant sunk costs. In this situation it is tempting for other constituencies to take advantage of any

[129] *Id.*
[130] *See* North (1990), *supra* note 117.
[131] *See* Bebchuk & Roe (1999), *supra* note 21, *and* Jeremy Grant & Thomas Kirchmaier: *Who Governs? Corporate Ownership and Control Structures in Europe* (SSRN Working Paper, June 7, 2004), *available at* http://ssrn.com/abstract=555877.
[132] *See* Bebchuk & Roe (1999), *supra* note 21.
[133] See Peter A. Hall & David Soskice, *Introduction* in VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE, *supra* note 38, at 1.

bargaining power they may have. Ultimately, then, corporate governance is a system of bargaining[134].

Changes in bargaining power will reflect overall changes in the political economy. Corporate constituencies are also interest groups that can use political means to further their own interests. Regulation can be seen as the outcome of the interaction between political and market structures, reflecting the impact of interested market participants and the political environment[135]. Changes in regulation can be seen to reflect changes in the relative bargaining power of these constituencies. In other words, the terms of the relationship between shareholders and managers will be renegotiated, in part, through political and regulatory intervention depending on how the relative political bargaining power of these constituencies evolves. In this respect corporate law and corporate governance regulation can be expected to reflect the institutional power of dominant corporate constituencies[136].

Corporations and the way they are governed are of considerable economic importance. Corporate governance has a significant effect on the preconditions for the creation of wealth and economic growth, as well as on the distribution of the cash flows and profits from corporate enterprise. It is natural that corporate governance should have considerable political implications as key corporate constituencies agree and renegotiate their relationships through the political framework. For example, in markets with a prevalence of concentrated ownership, corporate governance regulation can be expected to favour blockholders. In markets with dispersed ownership, where shareholders face coordination problems, corporate governance can be expected to favour management. Labor is also a significant corporate constituency often with considerable political clout. In basic agency analysis labor is sometimes understood as an external constituency as the contracts between the company and labor are assumed to be complete[137]. However, these contracts are often renegotiated depending on the relative bargaining power of unions. It cannot be assumed, for example, that if the role of labor increases significantly in the production chain, this would not affect corporate governance solutions.

In the EU it has been argued that the strong position of labor has had a strong influence on corporate governance. In Germany, for example, the impact of labor in direct governance issues has been significant. Moreover, management and shareholders will also want to renegotiate the terms of employment to ensure a well-functioning workforce[138] as the business environment evolves. Creditors are another external constituency, along with employees that also has significant interests in corporate governance that can be pursued through policy and regulation. In particular, in economies with a financial system dominated by financial intermediaries, such as banks, the role of external creditors in corporate governance has been significant.

Political economies are sufficiently complex so that they are rarely dominated by single political interests. In other words, a single constituency is rarely in the position to dictate policy. Gourevitch & Shinn have assessed the potential for political coalitions between

---

[134] Nobel (2009), *supra* note 105, at 176 - 179.
[135] *See* Mark Roe: *Political Preconditions to Separating Ownership from Corporate Control*, 53 STAN. L. REV. 539 (2000); *and* Roe (2003), *supra* note 39.
[136] Armour, Hansmann & Kraakman (2009), *supra* note 35, at 32.
[137] Gourevitch & Shinn (2005), *supra* note 106, at 8.
[138] *Id.*

different key corporate constituencies[139]. Different constituencies can seek to bargain with each other, or if interests are not sufficiently uniform within a group, their political influence can be divided. Gourevitch & Shinn have identified the key interests of each constituency and assess to what extent and in which circumstances two constituencies might form a political coalition in terms of corporate governance regulation[140]. They have identified three different basis for political conflicts and coalition preferences that are represented in different types of economies. First, a class conflict model posits shareholders ("owners of capital") in conflict with employees ("workers"). In this model management would be in coalition with shareholders[141]. If investors are politically dominant this model would lead to strong minority protection and dispersed ownership. However, in economies where employees are dominant there will be pressure on companies to provide higher salaries and job security at the cost of maximizing profits. As proposed by Roe, strong labor calls for a controlling shareholder to be able to negotiate with labor giving concentrated ownership structure an overall relative advantage in that economy.

Second, in a sectoral cleavage model, constituents with asset specific investments form political coalitions to protect their investment. In this model employees and managers would cooperate to protect their interests in the company and in the industry in general. An example of this model is the "Corporatist Compromise"[142] where managers and employees cooperate to promote stability, size of the corporation and insiders' claims on corporate income[143]. The regulatory framework would promote stability with rules favourable to blockholders and strong employee protection. Minority shareholder protection would not be strong.

The third model sees coalitions forming between shareholders and employees combining their interests to constrain managerial agency costs. Employees support shareholders with regard to corporate power but are compensated in job security. Alternatively, employees can have interests aligned with those of shareholders in the form of pension fund investments. The preferences of labor will be affected by how the pension system is structured. For example, the more social security and pensions are funded on a pay-as-you-go basis the less of a connection is perceived between corporate governance and future benefit streams. The more pensions are based on fully funded models, and the more benefits are linked to investment returns, the greater the connection to corporate governance outcomes[144].

[139] *Id.*
[140] *Id.* at 57-68.
[141] See Michael Hiscox, *Class versus Industry Cleavages: Inter-Industry Factor Mobility and the Politics of Trade*, 50 INTERNATIONAL ORGANIZATION 1 (2001).
[142] Gourevitch & Shinn (2005), *supra* note 106, at 64-65.
[143] *See* Pagano & Volpin (2001), *supra* note 118.
[144] Gourevitch & Shinn (2005), *supra* note 106, at 215.

Political Coalitions and Governance Outcomes*			
Coalitional Lineup	*Winner*	*Political Coalition Label*	*Predicted Outcome*
"Class Conflict"			
Owners+managers vs. workers	Owners+managers	"Investor"	Diffusion of shareholdings
Owners+managers vs. workers	workers	"Labor"	Blockholding
"Sectoral"			
Owners vs. managers+workers	Managers+workers	"Corporatist Compromise"	Blockholding
Owners vs. managers+workers	Owners	"Oligarchy"	Blockholding
"Property and Voice"			
Owners+workers vs. managers	Owners+workers	"Transparency"	Diffusion
Owners+workers vs. managers	Managers	"Managerism"	Diffusion
*Gourevitch & Shinn (2005), p.23			

The priorities of the different constituencies may change over time, as may the coalitions formed between different corporate constituencies. The interests of labor in Europe, for example, have been argued to have shifted towards supporting transparency and accountability in corporate governance – from a corporatist model to a transparency coalition favoring minority shareholders[145]. To some extent the structure of corporate ownership has also changed towards increased diffusion[146]. However, in many cases complementary institutions needed to support dispersed ownership have been lacking, preventing this development[147]. Scholars have analyzed the political developments in EU member states underlying this development, and some have noted a "party paradox" where pro-shareholder policies traditionally pursued by centre-right coalitions have been supported by centre-left governments[148]. The paradox has been explained by the evolving political economy, where labour interests have been adapted to a new industrial setting with an emphasis on increased transparency and accountability in corporate governance – that also supports minority interests[149].

The work of Gourevitch & Shinn suggests that regulatory models and the structure of corporate ownership are interdependent, and that the industrial dynamic affects outcomes in this regard. This suggests that regulatory models are likely to vary depending on the prevalent industrial structures and the relationships among the key corporate constituencies. As these environments vary across the EU it clearly can be challenging to develop and design regulatory models at the EU level.

---

145 *See* Barker (2010), *supra* note 116.
146 *Id.* at 283-291.
147 *See* Henreksson & Jakobsson (2012), *supra* note 67.
148 *See* Barker (2010), supra note 116, at 1-2.
149 Gourevitch & Shinn (2005), *supra* note 106, at 220-221.

C. EU LEGISLATIVE PROCESSES AND CORPORATE GOVERNANCE REGULATION

Supranational political systems such as the EU provide a solution to the need for coordinating economic interaction among varied economic and regulatory systems. Understanding the dynamics and challenges of developing regulation in this environment is important. The effects of regulation will depend on the applicable institutional environment while regulatory outcomes are the result of historical development, the influence of interested constituencies and the political environment[150]. Moreover, the special characteristics of supranational regulation must also be taken into account in considering the effects of regulatory intervention; these include the differences in institutional environments, the absence of uniform enforcement mechanisms and the dynamics of the multilevel regulatory environment created by the evolution of the EU regulatory framework[151]. These factors create unique challenges for the development of legal strategies.

The study will consider the political effects of the EU framework with respect to the dynamics of corporate governance regulation. The EU and its institutions form a political system akin other national or regional systems. The EU cannot merely be seen as an intergovernmental forum for the member states, of course, but rather as an independent political system facilitating the development of a multilevel governance system[152]. Moreover, EU integration as such, together with its institutional forms, reflects a polity in itself whereby certain political and economic agendas may be promoted[153]. In addition, the EU political institutions and the political processes for EU regulation pose their own challenges for pursuing regulatory change at the EU level[154]. The agendas and alliances of affected constituencies and interest groups may differ at the national and the EU levels[155] creating a challenging political dynamic to be taken into account when considering feasible strategies for regulatory intervention at the EU level. These characteristics of the EU must be understood when considering how EU regulation is formed.

It has been argued that "corporate governance evolves through a dynamic process of competing interests and competing interpretations of institutionalized norms, processes shaped by, but not fully determined by, political institutions"[156]. A central aspect in developing EU corporate governance regulation is related to the political dynamics of regulatory initiatives. Regulatory responses are the result of political processes and the efforts of affected constituencies pursuing their interest through the markets for regulation[157]. Regulatory outcomes will depend on the evolving preferences of interested constituencies, as

---

[150] *See* Roe (2003), *supra* note 39.
[151] *See* Helen Callaghan, *How Multilevel Governance Affects the Clash of Capitalisms* (MPIfG Discussion Paper 08, 2005), *available at* http://www.mpifg.de/pu/mpifg_dp/dp08-5.pdf.
[152] *See* POLICY-MAKING IN THE EUROPEAN UNION (Helen Wallace, Mark A. Pollack & Alasdair R. Young, eds., 2010), *see also* Callaghan (2008), *supra* note 151.
[153] Mark A. Pollack, *Theorizing EU Policy-Making, in* POLICY-MAKING IN THE EUROPEAN UNION, *supra* note 152, at 34-42; *see also* LAURA HORN, REGULATING CORPORATE GOVERNANCE IN THE EU: TOWARDS A MARKETIZATION OF CORPORATE CONTROL (2011); DERMOT MCCANN, THE POLITICAL ECONOMY OF THE EUROPEAN UNION (2010).
[154] *See* Callaghan (2005), *supra* note 151.
[155] Ferrarini & Miller, *supra* note 20, at 15.
[156] Aguilera & Jackson (2010), *supra* note 115, at 517.
[157] *See* Sam Peltzman, *Towards a More General Theory of Regulation*, 19 J. OF LAW AND ECON. 211 (1976), and George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. OF ECON. AND MANAGEMENT SCIENCE 137 (1971).

well as on the structure of political institutions[158]. In light of the political controversy surrounding the legislative process preceding the adoption of the Takeover Directive, and the current debate related to new EU corporate governance initiative, for example, the political aspects of EU regulation should not be underestimated. The political process underlying the adoption of the Takeover Directive was particularly convoluted and provides insights into how interested constituencies pursue their preferences through the EU political framework [159].The controversies reflected the significant differences in ownership and governance systems of listed companies in the EU member states[160]. The debate related to the more recent EU initiatives in the field of corporate governance may also add to our understanding of the political aspects of EU corporate governance regulation.

Some scholars believe that with the development of EU level regulation traditional industry groups will be able to coordinate their actions on an international level and focus their efforts to lobby favourable EU level regulation[161]. However, others argue that the EU framework creates a multilevel framework of regulation that affects how interested constituencies can pursue their interests through the political systems[162]. Key industry groups may have considerable political leverage at the national level, but may not be able to affect EU level regulation in the same way. For example, Ferrarini and Miller argue that at the national level takeover regulation may be more likely to favour target companies and their management, while the relative position of institutional investors may be better at the EU level, for example[163]. Callaghan points out that the EU contributes to the development of a multilevel governance framework – also with respect to corporate governance regulation. Callaghan argues that this creates new strategic opportunities for interest groups[164] and that the EU institutional set-up allows for competing political coalitions to simultaneously advance different reforms thus limiting the possibility for interest groups to monopolize policy.

Supranational political systems, such as the EU, provide an increasingly important platform for regulatory initiatives and affect the dynamics of regulatory processes as such[165]. A better understanding of these systems is an important precondition for understanding the dynamics of supranational regulation. In this respect procedural and political strategies are equally important when trying to understand or develop EU level regulation. The study will discuss the characteristics of the EU regulatory processes related to the development of corporate governance regulation. The study considers how the political framework of EU corporate governance regulation affects the choice of legal strategies, and how legal strategies can be developed to reflect the characteristics of this framework. The study seeks to provide a basis

---

158 *See* Gourevitch & Shinn (2005), *supra* note 106.
159 *See* Skog (2002), *supra* note 13.
160 Ownership in listed companies in the UK is typically widely dispersed with a strong institutional shareholder base. In Continental Europe, on the other hand, listed companies may have a single large shareholder or shareholder block with a controlling position. Controlling shareholders tend to be families, other corporations or governments rather than institutional shareholders. See Rafael La Porta et. al., *Corporate Ownership around the world*, 54 J. FIN. 471, 491-93 (1999).
161 Bastiaan van Apeldoorn & Laura Horn, *The Transformation of Corporate Governance Regulation in the EU: From Harmonization to Marketization, in* THE TRANSNATIONAL POLITICS OF CORPORATE GOVERNANCE REGULATION 77 (Henk Overbeek, Bastiaan van Apeldoorn & Andreas Nölke, eds., 2007).
162 *See* Hooghe & Marks (2000), *supra* note 37; Callaghan (2008), *supra* note 151.
163 *See* Ferrarini & Miller, *supra* note 20, at 15.
164 Callaghan (2008), *supra* note 151, at 10.
165 *See* POLICY-MAKING IN THE EUROPEAN UNION, *supra* note 152.

for the further development of political as well as legal strategies for EU level regulatory initiatives.

IV. COMPARATIVE CORPORATE GOVERNANCE AND THE DYNAMICS OF EU REGULATION

From a scholarly perspective this study is related to comparative corporate governance research[166]. The study is concerned with the apparently varying effects of EU corporate governance regulation in different corporate environments. The study applies comparative institutional analysis and findings from comparative corporate governance research with regard to the interaction of corporate governance regulation and different corporate environments.

The study is also concerned with the dynamics of legislative processes in supranational regulatory systems - more specifically, the EU. The study seeks to understand the dynamics underlying EU corporate governance regulation. This helps to explain the background of regulatory initiatives (and opposition to the same), and provides a framework for understanding regulatory outcomes. In approaching EU legislative dynamics the study builds on theories of EU integration and general political theories. With respect to the dynamics underlying corporate governance regulation specifically the study also applies economic theories of regulation.

The research methods applied in the study are described in more detail below.

A. COMPARATIVE CORPORATE GOVERNANCE RESEARCH

The study is related to comparative corporate governance research. This field of study has been of much interest over the past decades as globalization and market integration have increased the salience of the differences in corporate governance systems and the effects thereof[167].

As interaction increases between different kinds of national economic systems, the need for coordination among these systems increases also. Different scenarios for the outcomes of interaction between national systems include convergence, destabilization resulting from the implementation of elements foreign to the system, the disappearance of less-successful systems and the emergence of hybrid systems with an independent institutional architecture (such as EU integration)[168]. The identification of these types of scenarios emphasizes that a focus on national level solutions is insufficient for understanding the development of corporate governance regulation. The study of the emergence of different outcomes is important and the study of emerging political systems with their own institutional architecture is of particular interest in this regard.

---

[166] Jeffrey Gordon & Mark Roe, *Introduction, in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE, *supra* note 14, at 1; s*ee also* Lucian A. Bebchuk & Michael S. Weisbach, *The State of Corporate Governance Research*, 23 REV. OF FIN. ST. 939 (2010), Marc Goergen, *What do We know about Different Systems of Corporate Governance* (ECGI Finance Working Paper 163, 2007), *available at http://ssrn.com/abstract=981531*, *and* Klaus Hopt, *Comparative Corporate Governance: The State of the Art and International Regulation* (ECGI Law Working Paper 170/2011), *available at* http://ssrn.com/abstract=1713750.

[167] *Id.*

[168] *See* Aoki (1994), *supra* note 14.

There has been considerable interest in understanding the relationship between corporate governance and economic performance. Comparative corporate governance has provided a framework for studying the relationship between corporate performance and different corporate governance systems and whether certain systems are superior to others[169]. Comparative research has, for example, focused on corporate governance mechanisms adopted in different types of legal systems and argued for the superiority of certain systems in this regard[170]. The work of La Porta, Lopez-de-Silanes, Shleifer and Vishny[171] has been important in this field of research, and has triggered a large body of international comparisons[172]. Very often the model of dispersed ownership and shareholder supremacy, that is perceived prevalent in the United States, for example, has been used as a benchmark for measuring different corporate governance systems[173]. It has been argued that as markets become more integrated and product markets more competitive corporate governance systems must converge to the standards that are the most efficient[174]. Initially the observed persistence of different corporate governance systems was consequently of some concern. However, it has been recognized that corporate governance outcomes can reflect the requirements and dynamics of the given institutional environment, and that different corporate ownership and corporate governance models can form a competitive basis for firm performance[175]. Importantly, the "legal origins" explanations related to corporate governance systems have been called into question and it has been understood that the development of corporate governance is much more complex[176]. This is also relevant with respect to comparing corporate governance systems.

For the purposes of comparative analysis, comparative corporate governance scholarship has recognized the close relationship between corporate governance and the institutional environment, including industrial structures and history, capital markets, as well as the political system and the legal system[177]. Comparative methods should include holistic analysis of corporate governance systems. The business enterprise, the corporation and the dynamics among interested constituencies and society at large cannot be compared without reference to the relevant institutional environments. Comparative approaches must address the diversity of

---

[169] *See* Dennis C. Mueller & B. Burcin Yurtoglu, *Country Legal Environments and Corporate Investment Performance*, 1 GERMAN ECON. REV. 187 (2000), *and* Rafael La Porta, Andrei Schleifer & Robert Vishny, *Law and Finance*, 106 J. OF POL. EC. 1113 (1998).

[170] *See* Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Schleifer, *Corporate Ownership Around the World*, 54 J. FIN. 471, 491-93 (1999), Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Schleifer & Robert Vishny, Investor Protection and Corporate Governance, 58 J. FIN.ECON. 3 (2000).

[171] *Id.*

[172] Katharina Pistor, *Patterns of Legal Change: Shareholder and Creditor Rights in Transition Economies*, 1 EBOR 59, 72-79 (2000); *see also* Katharina Pistor, Martin Raiser & Stanislaw Gelfer, *Law and Finance in Transition Economies*, 8 ECON. OF TRANSITION 325 (2000).

[173] See, for example, Bebchuk & Weisbach (2009) supra note 166, at 19; *see also* Sofie Cools, *The Real Difference in Corporate Law between the United States and Continental Europe: Distribution of Powers* (Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series, Paper 490, 2004) *available at* http://lsr.nellco.org/harvard_olin/490.

[174] *See* Gordon & Roe (2010), *supra* note 166.

[175] Aoki (2010), *supra* note 89, *at* 180; *see also* Ronald Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy,* 119 HARVARD L.R. 1642 (2006).

[176] *See*, for example, John Armour, Simon Deakin, Prabirjit Sarkar, Mathias Siems & Ajit Singh, *Shareholder Protection and Stockmarket Development: An Empirical Test of the Legal Origins Hypothesis*, 6 J. OF EMPIRICAL L. STUDIES, 343 (2009).

[177] Aguilera & Jackson (2010), *supra* note 115, at 490.

institutions across jurisdictions, markets and time [178]. Indeed, comparative corporate governance has also focused on the diversity of the corporate landscape, and how corporate governance solutions evolve in different institutional environments[179]. Different mechanisms or institutions can have similar functions that are effective in their respective environments. The market for corporate control has been identified as a monitoring mechanism in dispersed ownership systems, but controlling shareholders may provide similar functions in systems based on concentrated ownership, while bank financing can provide such functions in other environments [180]. It may thus be impractical to compare different corporate systems independently of their institutional surroundings. In fact, it is argued, different modes of corporate architecture and governance "cannot be superior independently of the social and political milieu, history, technology, available individual cognitive assets, and so on. Rather, varieties of organizational forms may better serve society" [181]. Indeed, it has also been observed that different corporate governance systems are persistent in ways that may not have been expected. Institutional development may well be path dependent so that changes are affected by pre-existing conditions. In this respect many aspects of comparative corporate governance are aligned with the positions developed in new institutional economics[182]. Indeed, comparisons of corporate governance systems rely on the recognition that governance must be analyzed in the context of the relevant institutional environment.

Research has demonstrated the complex nature of corporate governance and its connectivity to broader themes of economic, cultural and political interaction. Comparative corporate governance research has been approached from different scholarly perspectives, including economics and management, culture and sociology, as well as legal and political paradigms[183]. Economic approaches have allowed for comparing different corporate governance systems based on the same economic premises. Macro-level studies have been concerned with whether corporate governance systems have contributed to the success of national or regional economies – and have thus been of significance from an economic perspective. In this respect corporate governance rules have been seen as a part of the overall financial system[184]. Legal approaches have considered the relationship between legal systems and corporate governance solutions. Finally, political approaches seek to provide political explanations for corporate governance outcomes with the understanding that political interests drive regulation – also with respect to corporate governance.

There has been an emerging awareness that research should increasingly seek to integrate these different paradigms[185], and this study seeks to make a contribution in this regard. Legal and economic approaches to comparative corporate governance are relied on to understand the effects of legal strategies in different institutional environments. While approaches based on law and economics research provide a basis for studying the corporation and the

---

[178] *Id.* at 491
[179] *See* Masahiko Aoki, *Towards an Economic Theory of the Japanese Firm*, 23 J.OF ECON.LITT. 1 (1990), *and* Aoki (2010), *supra* note 89.
[180] *See* Aoki (1990), *supra* note 179.
[181] Aoki (2010), *supra* note 89, *at* 180.
[182] *See* North (1990), *supra* note 117, Pistor (2000), *supra* note 172, at 61. With regard to the neo-institutional analysis of corporate governance in the context of EU integration, see also PEKKA TIMONEN, MÄÄRÄYSVALTA, HINTA JA MARKKINAVOIMA [Control, Price and Market Power], 69 and 118-119.
[183] Aguilera & Jackson (2010), *supra* note 115, at 485-486.
[184] *See* Arthur R. Pinto, Globalization and the Study of Comparative Corporate Governance [Symposium: Economic Globalization and Corporate Governance], 23 WISCONSIN I.NTL. L.J. 477 (2005).
[185] Aguilera & Jackson (2010), *supra* note 115, at 485-486.

relationships among corporate constituencies, it is important to study corporate governance regulation in the context of the broader institutional environment, including industrial structure, legal systems and politics. This study recognizes that regulatory solutions reflect the outcomes of political processes, and that the political dimensions of both corporate governance and the political institutional structure (of the EU) must be recognized for a better understanding of the dynamics of regulatory intervention. The study emphasizes that regulation must be understood and studied in its economic and political context. Regulatory action (or inaction) is the result of political processes with their own dynamics, including the effects of interest groups, political constituencies and the institutional political structure. Based on such an analysis the study seeks to identify the premises for developing EU legal strategies for corporate governance regulation.

B. SUPRANATIONAL REGULATION

The study is concerned with the dynamics of legislative processes at the EU level, and thus related to the study of EU integration. The study is based on the understanding that law and politics cannot be studied independently if the goal is to properly understand the dynamics of legislation and legislative processes[186]. The dynamics of supranational regulation, and the effects of the institutional structure of the EU, must also be taken into account when considering the development of EU corporate governance regulation and appropriate legal strategies. Research in EU law has emphasised the need to study EU law in the context of its evolving economic and political environment[187]. In some cases the special nature of the EU has been much emphasised and EU integration has been studied as a unique case[188]. However, it has also been argued that the EU must be understood as a political system that can be studied pursuant to terms of general political theory[189]. This study outlines the sphere of political bargaining with respect to corporate governance regulation at the EU level with the help of political theories of integration. The study then analyses EU corporate governance regulation with tools related to economic theories of regulation – i.e. how the "market for regulation" functions at the EU level with respect to corporate governance regulation.

Interest Groups and Regulation

Regulation can be seen as the outcome of the interaction between political and market structures, reflecting the impact of interested market participants and the political environment[190]. Changes in regulation can be seen to reflect changes in the relative bargaining power of these constituencies[191]. The political economy sets out the broader parameters for feasible regulatory outcomes. Within these parameters, the public choice literature identifies a "market for regulation" where political actors trade regulatory benefits for resources and where regulation can be captured by dominant interest groups[192]. In this model the redistributive effects of regulation are emphasized. Indeed, it is important to recognize that

---

[186] ANNA HYVÄRINEN, SUOMEN MAHDOLLISUUDET VAIKUTTAA EUROOPAN UNIONIN LAINSÄÄDÄNTÖMENETTELYYN [Finland's Possibilities to Exert Influence in Eu Law-Making] 7 (2015).
[187] Grainne de Búrca, *Rethinking Law in Neofunctionalist Theory*, 12 J. OF EUR. PUBL. POL. 310, 314-316 (2005).
[188] Helen Wallace, Mark A. Pollack & Alasdair R. Young, *An Overview, in* POLICY-MAKING IN THE EUROPEAN UNION, *supra* note 152, at 3, 11-12.
[189] *Id.* at 12.
[190] *See* Roe (2000), *supra* note 135 and Roe (2003), *supra* note 39.
[191] *Id.; see also* Stigler (1971), *supra* note 157.
[192] *See* Stigler (1971), supra note 157.

economic regulation will of course affect the distribution of wealth in the form of the reallocation of risks or opportunities, for example. It is rarely the case (if ever) that regulation would address "market failures" in a pareto-optimal manner[193]. Dominant, well organized constituencies will be able benefit from regulatory intervention. However, it has been pointed out that political utility maximization by political entrepreneurs is still likely to result in regulation that also takes into account the concerns of other political coalitions[194]. Regulatory initiatives will cause opposition that increases as the initiatives cause losses for other constituencies[195]. The laws of diminishing returns suggest that the political process will thus be drawn to more effective regulatory outcomes[196].

Different political constituencies have different requisites for pursuing their interests[197]. Small interest groups with similar interests can be expected to overcome coordination problems and look after their interests in a satisfactory way. Large interests groups with similar interests can be expected to pursue their interest through the political system. In the corporate environment unionized labor, for example, can be expected to use the political system to protect their interests. Even if labor would not be a direct participant or co-decision maker in corporate governance their political power is likely to guarantee that their interests are taken into account – within the parameters of the political economy. Large interest groups with heterogeneous interests may have difficulties in overcoming coordination problems or in having access to the political system. Minority shareholders have typically been categorized as a group with some difficulty in overcoming coordination problems. Minority shareholders have often been deemed to have sufficiently diverging agendas, and may not have sufficient financial interests involved, to allow for the coordination costs required to organize political cooperation. Thus minority shareholder interests can easily be trumped by the interests of politically more dominant groups. In some economies, where the political economy has developed so that labor favours equity interests, the situation is different. The ability of different interest groups to coordinate political action to pursue their interests can also be taken into account in developing regulation. Based on this, minority shareholders would not be the groups in the best position to coordinate activities at the political level with respect to corporate governance or takeover regulation, for example. The interests of these constituencies, then, may require specific attention from regulators if market based regulation and investor protection are desired.

The Regulatory Dynamics of Supranational Political Systems

It is important to recognize the effects of structure of supranational political systems, such as the EU, on the political dynamics of corporate governance regulation. The introduction of the EU framework has established a parallel regulatory framework to national regulation. Constituencies can pursue regulatory agendas through both the national and the EU regulatory frameworks[198]. An important element in the ability of interests groups to pursue their interests

---

[193] ANTHONY I. OGUS, REGULATION, LEGAL FORM AND ECONOMIC THEORY 59 and 72 (1994).
[194] Samuel Peltzman, *The Economic Theory of Regulation After a Decade of Deregulation* 13 (Brookings Papers on Economic Activity, 1989).
[195] See Gary Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 QUARTERLY J. OF ECON. 371 (1983).
[196] *Id.*
[197] *See* MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION (1971).

[198] *See* Callaghan (2008), *supra* note 151.

is that the dynamics of the market for regulation may be different at the national and international levels. Certain interest groups may have significant influence on regulation at the national level, while their ability to influence EU level regulation can be limited, for example. Ferrarini & Miller argue that the interests of corporate insiders remain strong at the national level[199]. With respect to takeovers, for example, target company interests may have more influence at the level of national regulation than the interests of bidders. At the domestic level, interest groups representing management, labour and community groups are likely to advocate for rules that increase the threshold for takeovers[200]. At the international (or federal) level, however, the influence of these interest groups may be more balanced[201]. Corporate insiders may not have the same relative advantage over the interests of bidders (and minority shareholders) who may better be able to organize themselves on an international basis.

The preference for regulatory competition (national regulation) or harmonization (EU regulation) may also be driven by how the relevant constituency can best promote its interest – in relative terms. Constituencies with considerable sunk costs and a high threshold for corporate mobility may not be able to take advantage of the freedom of establishment. To prevent competitors from taking advantage of more competitive regimes they would opt for EU level harmonization setting similar rules throughout the EU that would cater to existing industrial structures. Constituencies with lower costs for relocating, on the other hand, will lobby for national regulation and regulatory competition, as they can move their operations to jurisdictions with more favourable regulation, for example[202].

At the EU level it may be more difficult for individual interest group to promote their interests by affecting EU policies and regulations. Overall, the EU has resulted in a system of multilevel governance that may be less prone to be dominated by specific policies. The EU institutional set-up allows for competing political coalitions to simultaneously advance different reforms thus limiting the possibility for interest groups to monopolize policy[203]. Callaghan, for example, argues that the multilevel system established with the introduction of the EU framework increases strategic opportunities for using regulation to pursue policies across the EU – regardless of the national system of corporate governance[204]. Also, the institutional set-up of the EU allows different types of policies to be pursued simultaneously. In other words, it is not as easy for a single interest group (or coalition) to dominate the political agendas regarding a particular field of regulation. This can result in reforms reflecting, at the same time, different policies.

The different regulatory approaches to developing corporate governance regulation in the EU – harmonization and regulatory competition – also have significant political implications. The different approaches are linked to expected regulatory outcomes and reflect underlying political preferences. The dynamics of positive and negative integration differ. Negative integration and regulatory competition are often associated with a market oriented or laissez-faire approach to corporate regulation[205]. Generally negative integration limited to enforcing

[199] *See* Ferrarini & Miller, *supra* note 20.
[200] *See* Roberta Romano, *The Political Economy of Takeover Statutes*, 112 VIRGINIA L.R. 111 (1987).
[201] *See* Ferrarini & Miller, *supra* note 20.
[202] *See* Jeanne-May Sun & Jacques Pelkmans, *Regulatory Competition in the Single Market*, 33 J. OF COMMON MARKET STUDIES 67 (1995).
[203] *See* Callaghan (2008), *supra* note 151.
[204] *Id*.
[205] Johnston (2009), supra note 10, at 115-116.

treaty freedoms would result in deregulation at the national level, for example, as incompatible national rules would be trumped by treaty freedoms. Also, this approach relies less on political decision making and more on an increased role of the European Court of Justice. Positive integration through harmonization initiatives, on the other hand, always requires sufficient political support, whereas the effects of such harmonization initiative can vary depending on the policies pursued at the supranational level[206].

The institutional structure of the EU will also have a significant effect on policy. The dynamics of agenda-setting and decision-making in the key institutions, including the Council, the Commission and the EU Parliament, have their own dynamics that affect regulatory processes and outcomes. Also, the EU institutions do not only reflect the interests of national constituencies, but drive their own agendas as well. For example, the EU institutions may have an interest in increasing their overall influence as such. The different EU bureaucracies may be able to identify potential political alliances when promoting new regulatory initiatives[207] to ensure that the initiatives are acceptable to key political and industry actors. It is possible that the interests of industry representatives and governments vary among jurisdictions depending on the applicable economic structures, and that different alliances would be formed from time to time with regard to political and lobbying efforts. These efforts may overshadow the analytical advancement of the structure and design of regulation.

C. Premises for Developing EU Corporate Governance Regulation

This study approaches EU corporate governance regulation by first assessing the effects and efficacy of corporate governance mechanisms introduced in EU and national regulation in different types of corporate environments – with an emphasis on environments with a prevalence of concentrated ownership. The form and design of legal intervention are key factors for the efficient enforcement of policy. Different legal strategies may be required to ensure that legal intervention has the desired effects in different institutional environments. Strategies can vary from specific rules or standards to regulatory frameworks based on contractual arrangements. Enforcement of legal strategies can be based on private actions (court systems) or on public authorities, such as regulatory agencies. The efficient enforcement of certain legal strategies may depend on the quality of available court systems, for example. Legal strategies are also likely to vary depending on the applicable institutional environment so that they address the concerns and interests of dominant constituencies[208]. The study will consider the effects of certain regulatory instruments and compare these with the policy goals underlying the relevant regulatory initiatives. The study then considers how legal strategies can be selected so that they are better adapted to the relevant corporate environment and produce expected policy results. In this analysis the study will emphasize the political aspects of corporate governance to better understand the dynamics underlying existing corporate governance models and corporate governance systems.

This study incorporates political perspectives to the study of corporate governance and corporate governance regulation and establishes the resulting implications for legal strategies and regulatory design for EU corporate governance regulation. The analysis of regulatory processes is an important element of the study. It is not sufficient that legal strategies are

---

[206] *Id*.
[207] *See* McCann (2010), *supra* note 153, at 117.
[208] *See* Armour, Hansmann & Kraakman (2009), *supra* note 28.

chosen to accommodate for the structure of corporate ownership, but they also have to be politically feasible. The political environment and the broader political economy effectively define the framework within which legal strategies can be introduced. In developing EU regulation, the Commission may, for example, analyze the preferences of different political coalitions in assessing how regulation should be structured in order to be successfully introduced. It is also important to understand the relative bargaining power of interest groups at the national and EU levels in designing EU level regulation. The study seeks to understand the underlying political dynamic and its impact on EU level corporate governance and takeover regulation. The study recognizes that corporate law can be expected to reflect the institutional power of dominant corporate constituencies[209] and seeks to establish how EU regulation reflects this assumption; how these aspects are reflected in the characteristics of EU regulation and regulatory processes; and how EU legal strategies might be developed in this regard. Thus, having outlined the varied environment of corporate governance in the EU and the factors that affect the application and effects of EU level regulation, the study will look at the premises for developing legal strategies for EU corporate governance regulation to better take into account the characteristics of that environment. An important factor is the political dynamic underlying the introduction of EU level corporate governance regulation. The study applies theories of EU integration and political theory to outline the multilevel governance system where corporate governance regulation is pursued. The study then applies economic theories of regulation to study the introduction of specific corporate governance initiatives.

V. THE STRUCTURE OF THE STUDY

Following this introductory chapter, the study consists of six independent chapters with different approaches to the research questions presented earlier in the introductory chapter. The chapters build on and elaborate the themes raised in the introduction and discuss them in the context of the topics of each chapter. The chapters address corporate ownership and corporate governance issues that are relevant for the purposes of developing legal strategies in a varied institutional environment such as the European Union. Concentrated ownership, for example, is a recurring theme throughout the study, as are the Takeover Directive and more recent key EU corporate governance initiatives. The Nordic perspective is introduced in the different chapters as a tool for providing context for the research. The study concludes with a brief summary of findings and proposals for further research.

The chosen structure of the study allows an assessment of the themes of research from different perspectives and using different tools. The themes of research are general in nature and relate to the dynamics and processes of developing legal strategies and regulatory design in relation to EU corporate governance regulation generally. These themes become more concrete when discussed in a given context – such as the Nordic corporate environment or specific EU regulatory instruments. By approaching the research themes from different angles and in different contexts, the different factors that affect the dynamics of EU corporate governance regulation also become more transparent. Approaching the selected themes of research from different perspectives in largely independent chapters necessarily results in some repetition of descriptions of factual circumstances and research arguments. For example, the dynamics of corporate governance in an environment of concentrated ownership is discussed in the study in different contexts, and is further elaborated in the latter chapters.

[209] Armour, Hansmann & Kraakman (2009), *supra* note 35, at 32.

However, the structure of the study has allowed a detailed assessment of specific aspects of the themes of research in each chapter, providing for a more thorough understanding of the relevant dynamics of corporate governance regulation.

Below, the key theses of each of the chapters are briefly summarized.

Chapter 2: Bargaining Over Corporate Control – Regulating Concentrated Ownership in the EU

The chapter considers alternative definitions of corporate governance in the context of concentrated ownership. In this study concentrated ownership serves as a case study and provides a perspective for discussing the relationships among corporate constituencies. The chapter first introduces corporate governance concerns related to concentrated ownership, and questions the traditional premises of the relationship between concentrated ownership and private benefits of control or weak minority protection. In this regard, the chapter considers the relationships between the prevalent structure of corporate ownership, historical and industrial developments and the political environment.

The purpose of the chapter is to understand and define corporate governance in terms that recognize the legal, economic and political aspects of corporate governance. Some definitions anchored in agency-theory may neglect the external aspects of corporate governance, while purely political approaches sometimes fail to recognize the requirements of competitiveness and economic performance in how the governance of economic enterprise should be organized. The chapter builds the framework for how this study approaches corporate governance in the EU.

The modern corporation and much of corporate governance theory have been based on the premise of the separation of ownership and control and the agency problems that arise therewith. The resulting assumption is that shareholders are best served by diversifying their holdings, and corporate governance is focused on the alignment of agents' interests with those of principals and on the efficient monitoring of agents' performance. In these circumstances control rights are best allocated with the holders of residual cash flows, i.e. the shareholders.

In this approach, corporate governance relates to efficient monitoring and incentivising of agents. This perspective does not seem wholly satisfactory, however, and does not fully reflect prevalent forms of corporate governance. While agency theory may accurately describe the nature of the conflict of interests between economic actors in business, it does not necessarily give an accurate picture of the dynamics of the relationship between these parties. For example, the emphasis on shareholder primacy may be related to the importance of equity capital characteristic to prevalent industrial structures, and reflect corporate governance outcomes in a specific industrial environment. Also, in an environment of incomplete contracts it is not always clear who is the principal and who is the agent.

The chapter considers corporate finance and corporate governance outcomes as the results of on-going bargaining among corporate constituencies, where concentrated ownership represents one result of such bargaining. In this approach the structure of corporate finance is closely related to corporate governance as different combinations of corporate finance instruments provide different rights for investors and entrepreneurs, and reflect the bargaining outcomes between these parties. This approach recognizes that bargaining does not occur in a vacuum, and that politics and changes in regulation are different means for constituencies to conduct bargaining. Different constituencies have different means to affect regulation that can change over time and vary at the national and supranational levels. This leads to a complex regulatory environment that must be better understood. The chapter concludes by considering the regulatory implications of bargaining theory in the context of EU corporate governance regulation.

Chapter 3: A Political Narrative of Nordic Corporate Governance: Shareholders, Stakeholders and Change of Control[210]

The following chapter provides a political narrative of Nordic corporate governance. The chapter discusses the relationship between industrial and political developments and different structures of corporate governance and corporate ownership. The chapter focuses on the Nordic region in the EU where concentrated ownership remains prevalent - but with reportedly low levels of private benefits of control. The chapter discusses and analyses the development of corporate governance in Sweden and Finland. The purpose of the chapter is to emphasize the political aspects of corporate ownership and corporate governance.

Corporate governance models in the Nordic countries have been subject to increasing interest in the international corporate governance debate. Concentrated ownership combined with reportedly low private benefits of control has been seen as a competitive model of governance. The low levels of private benefits in the Nordics have been explained as the result of the non-pecuniary nature of control benefits or the social norms characteristic to the Nordic environment. However, the effects of the political environment on the corporate governance framework should not be underestimated in this regard.

The chapter argues that private benefits of control in the Nordics have been limited mainly due to an export-driven industrial structure open to product market competition while economic crisis and the development of pension systems have decreased resistance to better investor protection. These developments reflect expectations based on models presented by Gourevitch & Shinn[211]. However, the Nordic governance models are in fact not without challenges as the institutional framework continues to support block-holding and change of control remains subject to the consent of controlling shareholders, for example.

The chapter seeks to make a contribution to the debate on the relative merits of national and supranational regulation in the field of corporate governance in the EU. The chapter argues that the evolution of the EU as a parallel political framework has, in fact, provided a welcome avenue for regulatory change that can circumvent entrenchment in national level corporate regulation. Corporate constituencies have deeply entrenched interests in corporate governance and takeover regulation at the national level. There is no guarantee that regulatory initiatives at this level would necessarily do anything but further entrench these interests. Corporate structures still remain locked-in at the national level and regulatory competition has not yet

[210] An abbreviated version of the chapter has been published in the European Company and Financial Law Review (4/2015), and as a working paper on the Social Science Research Network; see Klaus Ilmonen, *A Political Narrative of Nordic Corporate Governance: Shareholders, Stakeholders and Change of Control,* 12 ECFR 489 (2015), and Klaus Ilmonen, *Explaining Nordic Corporate Governance: A Political Narrative* (working paper, 2014) *available at* http://ssrn.com/abstract=2748741.
[211] Gourevitch & Shinn (2005), *supra* note 106.

developed to provide a viable alternative to harmonization. The paper concludes with considering appropriate EU level regulatory strategies for corporate governance regulation in this environment.

Chapter 4: Towards a Nordic Corporate Governance Index: Metrics for Concentrated Ownership

In the next chapter the study considers the relationship between corporate governance mechanisms and the structure of corporate ownership. The chapter focuses on the relevance of different corporate governance mechanisms in relation to concentrated ownership. The chapter builds on papers critical of universal corporate governance indices.

The relevance of corporate governance mechanisms varies considerably. Some mechanisms are less critical than others and, in particular, many mechanisms that may be effective in a specific institutional environment are not nearly as relevant in other circumstances. The structure of corporate ownership is a key factor in this regard. Mechanisms that provide oversight for shareholders in the context of dispersed ownership may not be relevant in the context of concentrated ownership. The dynamic of a general meeting of shareholders is completely different if the vote is largely dominated by a controlling shareholder than in the case of dispersed ownership. Given how complementary institutions develop to support existing structures of corporate ownership these differences will also be reflected in the type of matters considered by general meetings, and how decision making is regulated.

The chapter considers corporate governance indices used to assess corporate governance in the Nordic countries (Sweden and Finland, specifically). The chapter then looks at the extent to which the mechanisms used in those indices are relevant in a Nordic context. The chapter then seeks to contribute towards developing a corporate governance index better adapted to circumstances prevalent in the Nordic environment.

The chapter contributes to the topic of the study by assessing the impact of corporate governance mechanisms in a specific institutional environment, including the structure of corporate ownership and the political environment. This assessment provides the basis for considering legal strategies appropriate for concentrated ownership. The chapter also looks to expand the scope of factors used in assessing the relationship among corporate constituencies. Corporate governance in different jurisdictions cannot be compared based on the availability of individual corporate governance instruments; a more holistic analysis is needed to understand the dynamics among different corporate constituencies. Factors that are relevant for the purposes of corporate governance are not limited to company law regulation, but include employment regulation and tax rules as well, among other. Moreover, the enforcement of regulation must also be taken into consideration, including the quality of the court system, for example.

Chapter 5: The Law and Politics of the Company Law Action Plan – Towards a Federal System of Corporate Governance Regulation in the EU

The chapter contributes to the study by providing a case study on the political aspects of corporate governance at the EU level in light of recent regulatory initiatives. The chapter considers the political dynamic of EU level corporate governance regulation with a focus on initiatives that address corporate governance systems based on concentrated ownership. The chapter specifically considers recent corporate governance initiatives of the EU as a case study in assessing the political economy implications of EU regulatory initiatives.

The European Commission's corporate governance initiatives have raised concern among corporate constituents in the EU member states. The initiatives have been seen to decrease the competitiveness of the publicly listed companies in the EU and the EU financial markets. It has been argued that the EU has failed with respect to corporate regulation and that corporate governance should be regulated at the national level.

The Company Law Action Plan is an important element in the on-going conflict between harmonization and regulatory competition in the EU. Regulatory initiatives are being increasingly introduced on international forums outside traditional legislative and political processes and it may be important for the EU to find a role in such forums to avoid being marginalized. Also, regulatory competition in the EU has not yet provided a fully viable alternative to harmonization. Delegating regulation to the national level in this environment - with national lock-ins remaining - would enable nationally entrenched interests to persist even if they were sub-optimal. Thus it still remains important to provide EU level regulatory initiatives.

Overall, the chapter finds that the Company Law Action Plan does not significantly alter the positions among corporate constituencies or reflect significant changes in the political economy – despite having its origins in political reactions to the financial crisis. Overall, the plan reflects dominant market liberal trends but introduces, as can be expected, regulatory elements based on the increased political salience of corporate regulation in the period after the financial crisis. The Commission initiatives mainly reflect the trend of how political decision making is concentrating to larger blocks at the cost of national governments. In this respect the EU level may remain an important source of corporate law going forward. This emphasizes the importance of understanding the political dynamics of EU corporate governance regulation.

While some of the proposals in the action plan are novel and well-advised, other potential solutions presented by the Commission would challenge the functioning of prevalent corporate governance systems in light of current research and may not contribute to a more competitive European market place for corporations. While corporate governance regulation has many political implications, the adopted solutions have significant economic effects. In this respect the EU Commission should reconsider some of the initiatives, while it may well choose to pursue a more robust role in corporate governance regulation overall. The paper calls for adopting legal strategies at the EU level that support diverse corporate governance systems and different structures of corporate ownership and control.

Chapter 6: Law and Politics of Supranational Regulation: Developing Legal Strategies for EU Corporate Governance Regulation

This chapter builds on the research in the previous chapters and summarizes the political dynamic of EU corporate governance regulation. The chapter builds on understanding the EU as a supranational political system and a solution for coordinating interaction among different economic and regulatory models. These types of systems pose their own challenges for policy and regulation, as the same regulation is applied throughout a varied institutional landscape, while the political dynamics are affected by the supranational political institutions. As the importance of the EU increases with further economic integration it is more important than ever to analyze and develop the types of legal strategies used for supranational regulatory intervention.

The chapter identifies challenges for introducing EU corporate governance regulation with respect to enforcing policy and with respect to introducing regulation for varied structures of corporate ownership. The chapter then identifies available legal strategies and outlines a typology of strategies appropriate for different types of situations. The chapter then provides a brief outline for developing policy for EU corporate governance regulation.

Chapter 7: The EU Takeover Directive: Developing Legal Strategies for Concentrated Ownership

The chapter looks at the Takeover Directive and its provisions that were deemed controversial in the context of concentrated ownership. The chapter looks at how the mechanisms of the directive were adapted (or not adapted) to corporate governance systems based on concentrated ownership and whether the mechanisms might have been better designed to address the concerns underlying the directive while not raising such opposition among key interest groups.

The chapter serves as a case study on the application of EU level regulation in an environment of concentrated ownership – and an example for the application of the qualitative model for developing legal strategies at the EU level outlined in chapter 6. The chapter describes and analyses the implications of concentrated ownership in the EU and identifies the key regulatory concerns related to concentrated ownership in a path dependent institutional environment. The paper suggests that the factors affecting ownership structure are complex and that regulatory intervention may not lead to dispersed ownership in the absence of a broader institutional environment supporting such structure. Indeed, it is not clear that dispersed ownership would provide for a superior model of corporate ownership in many EU member states.

The chapter considers EU level legal strategies for takeover regulation in light of the differences in the institutional environment among EU member states and the special characteristics of supranational regulation. The chapter considers how the effects of EU level regulation differ among member states depending on the institutional environment. The chapter also considers whether the legal strategies and regulatory tools chosen by the EU Commission were appropriate for the goals set out for regulatory intervention.

The chapter is mainly concerned with developing legal strategies and the design of regulatory tools at the EU level. The chapter will consider the types of legal strategies used in EU takeover regulation. The study looks at how legal strategies address different agency relationships (shareholders-managers, majority shareholder – minority shareholders), as well as which legal strategies are appropriate for different institutional environments (dispersed ownership, concentrated ownership, availability of enforcement mechanisms). The paper also considers how legal strategies can be developed taking into consideration the applicable political environment. The findings in the chapter will be used to develop a broader typology of legal strategies used in EU level corporate governance regulation.

The chapter suggests that EU initiatives for regulating concentrated ownership have been flawed - in particular with regard to the EU Takeover Directive. The chapter argues that, instead, it is important to develop regulatory responses that address both the agency problems related to concentrated ownership and the challenges of entrenchment. The conclusion of the paper with regard to EU corporate regulation is that instead of seeking to discourage concentrated ownership as such, EU rules should limit operational private benefits of control and encourage change of control where current structures have become inefficient. Regulatory proposals with regard to EU takeover regulation are provided in the conclusions of the chapter.

Chapter 8: Conclusions: Nordic Perspectives on EU Corporate Governance Regulation

The final chapter provides brief responses to the research questions posed in the introductory chapter. It also provides insights on the Nordic perspective on EU regulatory policies on corporate governance. The chapter also discusses further research opportunities based on the findings of the study. In this regard, the study recognizes that much research is still needed on the development of EU corporate governance regulation, and identifies comparative institutional analysis and the analysis of regulatory policy as areas where more empirical and theoretical work is called for.

PART II

PERSPECTIVES
ON CORPORATE GOVERNANCE
AND CONCENTRATED OWNERSHIP IN THE EU

CHAPTER 2

BARGAINING OVER CORPORATE CONTROL: REGULATING CONCENTRATED OWNERSHIP IN THE EU

The position of controlling shareholders has at times been difficult to reconcile with effective corporate governance regulation in prevalent models of corporate governance regulation. Mechanisms that are available for monitoring controlling shareholders in the context of concentrated ownership have been deemed inadequate and ineffective, for example. These concerns have been reflected in corporate governance regulation, including a number of EU corporate governance initiatives. However, concentrated ownership remains prevalent in many EU jurisdictions and has demonstrably provided a competitive basis for economic enterprise and corporate governance. There is a need for defining corporate governance in terms that reflect the differences in the broader corporate environment.

This chapter approaches corporate governance as the outcome of bargaining over the terms of corporate financing, and argues that the structure of ownership and corporate governance outcomes reflect the characteristics and requirements of the broader institutional landscape. The chapter then considers the resulting implications for EU corporate governance regulation. The theme of the study is of topical relevance, as the EU Commission is pursuing new initiatives in the field of corporate governance regulation.

I. INTRODUCTION: CONCENTRATED OWNERSHIP AND CORPORATE GOVERNANCE

A. CORPORATE GOVERNANCE CONCERNS

The position of controlling shareholders has often been deemed problematic in corporate governance regulation.[1] For example, there has been concern that corporate governance systems based on concentrated ownership have been inadequate for the effective monitoring of controlling shareholders.[2] Corporate governance systems based on concentrated ownership have been associated with low levels of investor protection, where controlling shareholders are assumed to enjoy private benefits of control.[3] These concerns have been reflected in corporate governance regulation, including a number of EU corporate governance initiatives.[4] There has been considerable focus on assessing the quality of corporate governance regulation based on the availability and efficiency of monitoring mechanisms and regulations restricting the use of control rights by large shareholders.[5] However, it is unclear whether regulatory

[1] *See* Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Schleifer & Robert Vishny, *Investor Protection and Corporate Governance*, 58 JSE, 3-27 (2000).
[2] *See* Marco Becht, Patrick Bolton & Ailsa Roell, *Corporate Governance and Control* 17-21 (ECGI Finance Working Paper 02/2002) *available at* http://ssrn.com/abstract_id=343461.
[3] *See* La Porta et al. (2000), *supra* note 1.
[4] *See* Commission of the European Communities, *Impact Assessment of the Proportionality Between Capital and Control in Listed Companies*, Commission Staff Working Document SEC(2007) 1705 (2007), *available at* http://ec.europa.eu/internal_market/company/docs/shareholders/impact_assessment_122007.pdf.
[5] *See* La Porta et al. (2000), *supra* note 1.

intervention based on these factors is adequate in all cases. The assumptions on which corporate governance regulation have been premised may not always reflect the dynamics of the institutional environment.

Concentrated ownership remains prevalent in many EU jurisdictions and has demonstrably provided a competitive basis for economic enterprise and corporate governance.[6] This is not necessarily reflected in EU corporate governance regulation, which has not been tailored to an environment of concentrated ownership.[7] It has been argued that models for corporate governance regulation adopted from jurisdictions with dispersed ownership may not be suited to corporate governance systems based on concentrated ownership,[8] the failed break-through rule in the EU Takeover Directive[9] and the one-share-one-vote initiative being two relevant examples.[10] The proposed break-through rule would have limited the effects of control enhancing mechanisms in connection with takeovers, while the one-share-one-vote initiative would have limited the introduction of certain control enhancing mechanisms altogether. Both initiatives were deemed controversial and met with sufficient resistance to prevent the introduction of new mandatory regulation. In light of the outcome, consideration should be given to the adoption of other regulatory approaches better suited to addressing regulatory concerns related to the position of controlling shareholders.

This study looks for alternative approaches to regulating the position of controlling shareholders that would be better adapted to concentrated ownership and considers the resulting implications for EU corporate governance regulation. The study argues that a focus on regulatory mechanisms allowing for effective monitoring may be an inadequate basis for regulatory intervention in an environment of concentrated ownership. Instead, the study looks for alternative approaches that reflect the characteristics and dynamics of the relationships between corporate constituencies in such an environment. For example, it has been suggested that different forms of corporate ownership and control can also be seen to reflect the results of bargaining among corporate constituents in a particular institutional environment, with concentrated ownership seen to represent one outcome of such bargaining.[11] Accordingly, corporate governance has also been defined as the broader framework for bargaining among these constituents.[12] Moreover, corporate governance reflects the industrial developments and

---

[6] *See* Harold Demsetz & Kenneth Lehn, *The Structure of Corporate Ownership: Causes and Consequences*, 93 J. OF POL. EC., 1155-1177 (1985); Torben Pedersen & Steen Thomsen, *Ownership Structure and Value of the Largest European Firms: The Importance of Owner Identity*, 7 J. OF MANAGEMENT AND GOVERNANCE, 27-55 (2003); *see also* Harold Demsetz & Belen Villalonga, *Ownership Structure and Corporate Performance*, 7 J. OF CORP. FIN. 209, 210 (2001).

[7] *See* Paul Davies, Edmund-Philipp Schuster & Emilie van der Walle de Ghelcke, *The Takeover Directive as a Protectionist Tool?* (ECGI Law Working Paper No. 141/2010), *available at* http://ssrn.com/abstract=1554616.

[8] Marc Goergen, Marina Martynova & Luc Renneboog, *Corporate Governance Convergence: Evidence from Takeover Regulation* 29 (ECGI Working Paper No. 33/2005), available at http://ssrn.com/abstract=709023.

[9] Directive 25/2004/EC of the European Parliament and of the Council of 21 April 2004 on Takeover Bids, 2004 O.J. (L142) [hereinafter Takeover Directive].

[10] *See* Rolf Skog, *The Takeover Directive – an Endless Saga?*, 13 EUR. BUS. L REV. 301-312 (2002); and *Charlie McCreevy, Commissioner, Speech at the European Parliament's Legal Affairs Committee*, October 3, 2007, *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/592.

[11] Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560, 586-587 (2013).

[12] *See* MASAHIKO AOKI, TOWARD A COMPARATIVE INSTITUTIONAL ANALYSIS (2001), John C. Coffee, *Unstable Coalitions: Corporate Governance as a Multi-Player Game*, 78 GEO.L.J. 1495 1989-1990 and Manuel A. Utset, *Towards a Bargaining Theory of the Firm*, 80 CORNELL L.REV. 540 (1995).

political environment that affect the bargaining framework.[13] This approach to corporate finance and corporate governance reflects the dynamic nature of the relationships between corporate constituencies in an evolving corporate environment. This study considers the resulting regulatory implications for corporate governance, control and concentrated ownership, focusing, in particular, on regulation in the EU, where concentrated ownership remains characteristic to the corporate environment. The theme of the study is timely, as the EU Commission is considering the need for new initiatives in the field of corporate governance regulation.

B. BARGAINING OVER CORPORATE GOVERNANCE

It has been argued that the nature of the firm has been changing.[14] Industrial structures have evolved with the expansion of new technologies; vertical integration of manufacturing has decreased and the boundaries of the firm have become less firm; so that the adoption of different financing and governance models can easily affect them[15] In general, the importance of human capital in the corporate enterprise has increased.[16] Current corporate theories largely originate from an era where the relative importance or bargaining power of corporate constituencies was different, and this may be reflected in how the roles of corporate constituencies have been defined in corporate governance regulation. For instance, the emphasis on shareholder primacy may be related to the importance of equity capital characteristic of formerly prevalent industrial structures. As these structures are now changing, it is appropriate to reconsider the basis for corporate governance regulation. For example, in the prevailing environment the balance between investor interests and the control rights of agents (or entrepreneurs) may well warrant re-examination.[17]

Agency theory emphasizes the need for principals to monitor and control the activities of agents in the corporate environment. This is often reflected in corporate governance regulation emphasizing the importance of different types of monitoring mechanisms. However, it may be useful to view corporate constituencies as independent actors who may have complementary interests allowing for efficient bargaining outcomes. Different forms of corporate ownership and control can be seen to reflect the results of bargaining over the terms of corporate finance and corporate governance, where the institutional environment and the life-cycle of the corporation may affect the choice of ownership structure and where concentrated ownership is one outcome of such bargaining.[18] This study argues that while the concentration of control rights can be a key prerequisite for firm-specific investments, it does not necessarily result in the extraction of private benefits of control. Concentrated ownership and control enhancing mechanisms may often be associated with poor investor protection and private benefits.[19] Nevertheless, both have also been observed in environments with low levels of private benefits of control, where they have provided a competitive basis for

[13] *See* Aoki (2001), *supra* note 12; *see also* Mark J. Roe, *Political Preconditions to Separating Ownership from Corporate Control*, 53 STAN. L. REV. 539 (2000).
[14] *See* Luigi Zingales, *In Search of New Foundations* (NBER Working Paper Series 7706, 2000), *available at* http://www.nber.org/papers/w7706.
[15] *Id.* at 3.
[16] *Id.*
[17] *See* Goshen & Hamdani (2013), *supra* note 11.
[18] *Id.* at 26-29.
[19] *See* Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Schleifer, *Corporate Ownership Around the World*, 54 J. FIN. 471, 491-93 (1999) [hereinafter La Porta et al. (1999)].

corporate governance.[20] This suggests that a better understanding of the underlying causes of different forms of corporate ownership may still be needed. This can also have implications for the regulation of the relationships between corporate constituencies.

Corporate governance provides the framework for exercising control over the use of corporate assets and for allocating revenues among corporate constituents. The financial structure of the corporation, including the terms of debt and equity financing, are important factors in this regard. In fact, corporate governance and corporate finance outcomes can be defined in terms of financial contracting, where entrepreneurs and providers of finance bargain over the terms of corporate finance and the related cash-flows and governance rights in a given institutional environment.[21] Financial instruments, such as equity, debt and their different combinations, with attached cash-flow and governance rights, can be seen as the building blocks of both corporate finance and corporate governance.[22] Different combinations of financial instruments and corporate governance solutions thus reflect the outcome of bargaining among corporate constituencies. In the context of concentrated ownership, the bargaining-perspective may be particularly useful, as controlling shareholders can be seen as entrepreneurs and concentrated ownership as one corporate governance outcome of bargaining.[23] This approach to corporate finance and corporate governance reflects the more dynamic nature of the relationships between corporate constituencies in an evolving corporate environment.

This study recognizes the problems related to the entrenchment of corporate control and that the transfer of corporate control may require to be facilitated through appropriate regulatory strategies. However, the study finds that the concentration of corporate control may be a general characteristic of corporate governance and that corporate governance mechanisms based on outside monitoring have been less effective than assumed, regardless of ownership structure.[24] Consequently, other types of mechanisms should be introduced for regulating the relationship between entrepreneurs and investors and for facilitating the transfer of control.

C. CONCENTRATED OWNERSHIP IN THE EU

This study is concerned with corporate governance in the context of concentrated ownership and provides a review of research on different aspects of concentrated ownership and corporate control. As discussed, concentrated ownership, especially combined with control enhancing mechanisms, is often deemed problematic for the purposes of corporate governance. Nonetheless, this form of ownership dominates much of the European corporate landscape with respect to both privately and publicly held (i.e., listed) companies.[25]

---

[20] *See* Pedersen & Thomsen (2003), *supra* note 6 and Christian Weiss, *The Ownership Concentration of Firms: Three Essays on the Determinants and Effects* 133 (Dissertation, European Business School, International University Schloss Reichanthausen, 2010), *available at* http://hdl.handlenet/10419/30247.
[21] *See* Oliver Hart, *Financial Contracting* (NBER Working Paper 8285, 2001) *available at* http://www.nber.org/papers/w8285.
[22] *See* Goshen & Hamdani (2013), *supra* note 11.
[23] *Id.* at 6; *see also* Oliver Hart & John Moore, *Property Rights and the Nature of the Firm*, 98 J. OF POL. EC. 1119 (1990).
[24] *See* Joseph E. Stiglitz & Aaron S. Edlin, *Discouraging Rivals* 1-3 (NBER Working Paper 4145, 1992), *available at* http://www.nber.org/papers/w4145 and Martin Hellwig, *On the Economics and Politics of Corporate Finance and Corporate Control* in CORPORATE GOVERNANCE: THEORETICAL AND EMPIRICAL PERSPECTIVES 95 (Xavier Vives, ed., 2000).
[25] *See* THE CONTROL OF CORPORATE EUROPE (Fabrizio Barca & Marco Becht, eds., 2001); Mara Faccio & Larry H.P. Lang, *The Ultimate Ownership of Western European Corporations,* 65 JFE 365, (2002), and La Porta et al. (1999), *supra* note 19.

Consequently, it remains important to consider the corporate governance implications of concentrated ownership from a European perspective. Considering the controversies related to EU corporate governance initiatives targeting control structures related to concentrated ownership, it is important to assess whether other, less controversial, approaches to regulating the position of controlling shareholders could be adopted.

The potential for conflicts of interest among corporate constituencies is emphasized in connection with change of control transactions. These situations may provide an opportunity for re-bargaining or, indeed, for extracting private benefits at the cost of other constituencies. For these reasons, the study will also briefly examine the application of the bargaining approach outlined above to EU-level takeover regulation. The theme of the study is timely, as the EU Commission is considering the need for new initiatives in the field of corporate governance regulation, including proposals for new regulation on related-party transactions.

This chapter proceeds as follows. After an introduction to the theme of the study (Section I), the chapter reviews research on different aspects of concentrated ownership and corporate control (Section II). Next the study discusses corporate governance arrangements and the allocation of control and cash-flow rights from the perspective of financial contracting, highlighting the perspective of the entrepreneur in negotiating with the providers of corporate finance (Section III). The study then turns to factors affecting the bargaining outcome, including the core legal elements of the corporation and other external factors (Section IV). The chapter then discusses concentrated ownership and control as a specific outcome of bargaining over corporate finance and the regulatory implications thereof (Section V). This section also discusses the application of these observations to EU-level corporate governance and change of control regulation. Section VI presents the conclusions of the study.

II. EXPLAINING CONCENTRATED OWNERSHIP

There has been much research into the underlying causes of different forms of corporate ownership.[26] In particular, concern has been expressed that governance models based on concentrated ownership are less competitive than those based on dispersed ownership.[27] However, in recent years there has been some concern related to the perceived lack of shareholder involvement in dispersed ownership[28]. There have been concerns that corporate governance models are failing due to inadequate monitoring by dispersed shareholders[29]. As a result there has been an emerging interest in the role of large shareholders and in corporate governance solutions based on concentrated ownership[30].

Below, this study briefly examines the debate on concentrated ownership, and the theories that underlie the debate, in order to demonstrate the need to better understand the underlying causes for variations in corporate ownership and corporate governance.

A. SEPARATION OF OWNERSHIP AND CONTROL VS. CONCENTRATED OWNERSHIP

[26] *See* La Porta et al (1999), *supra* note 19, Stijn Claessens et al, *The Separation of Ownership and Control in East Asian Corporations*, 58 JFE 81 (2000), and Faccio & Lang (2002), *supra* note 25.
[27] *See* La Porta et al (1999), *supra* note 19.
[28] *See* Lynn Dallas, *Short-Termism, the Financial Crisis and Corporate Governance*, 37 J. CORP. L. 264 (2011).
[29] *Id.*
[30] *Report of the Reflection Group on the Future of EU Company Law* (April 5, 2011), *available at* http://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en.pdf [hereinafter Reflection Group Report (2012)], and *EU Commission Green Paper, The EU Corporate Governance Framework* COM(2011) 164 final (April 5, 2011).

The modern corporation and much of corporate governance theory have been based on the premise of the separation of ownership and control and the agency problems that arise therewith.[31] The resulting assumption is that shareholders are best served by diversifying their holdings, and corporate governance is consequently focused on the alignment of agents' interests with those of principals and on the efficient monitoring of agents' performance. In these circumstances control rights are best allocated to the holders of residual cash flows, i.e., the shareholders.

In this paradigm, the ability to control corporate strategy and the use of corporate assets in the absence of effective monitoring mechanisms is generally deemed problematic and often associated with the extraction of private benefits of control.[32] Similarly, the costs associated with maintaining large, undiversified holdings are assumed to be covered by these private benefits. For example, controlling shareholders are assumed to extract benefits through tunneling[33] or by leveraging their control positions through control enhancing mechanisms and taking more risk than is beneficial to the minority shareholders.[34] In some cases it is argued that private benefits are non-pecuniary, i.e., that controlling shareholders may have non-monetary interests, such as political influence or the social status sometimes associated with corporate control.[35] Nevertheless, typically these aspects of corporate control have still been defined in terms of private benefits. Concentrated ownership and control enhancing mechanisms have often been associated with unsatisfactory investor protection and the extraction of private benefits of control – with some justification.[36] The principle of separation of ownership and control and the agency problems related therewith also support the notion that for the purposes of efficient risk allocation and management incentives, concentrated ownership may not be an optimal structure of ownership. In corporate governance regulation, these assumptions have often been reflected, for example, in a focus on limiting private benefits of control and the control rights of large shareholders.

Assumptions regarding the role of controlling shareholders have nevertheless been called into question, and have been deemed to overly simplify the underlying causes of different structures of corporate ownership and control.[37] Both concentrated ownership and different types of control enhancing mechanisms have also been observed in environments with reportedly low levels of private benefits of control.[38] In Sweden, for example, concentrated

[31] *See* Michael Jensen & William Meckling, *Theory of the Firm – Managerial Behavior, Agency Costs and Ownership Structure*, 3 JFE 305 (1976).
[32] *See* John Armour, Henry Hansmann & Reinier Kraakman, *Agency Problems and Legal Strategies*, in THE ANATOMY OF CORPORATE LAW 35 (Reinier Kraakman et al., 2004).
[33] *See* Luca Enriques & Paolo Volpin, *Corporate Governance Reforms in Continental Europe*, 21 J. ECON. PERSP. 117 (2007) and Simon Johnson, Rafael La Porta, Florencio Lopez de Silanes & Andrei Shleifer, *Tunnelling* (Harvard Institute of Economic Research Paper No. 1887, 2000), *available at* http://ssrn.com/abstract=204868 or http://dx.doi.org/10.2139/ssrn.204868.
[34] *See* Lucian A. Bebchuk, Reinier Kraakman & George Triantis, *Stock Pyramids, Cross-Ownership and Dual Class Equity: The Creation and Agency Costs of Separating Control from Cash Flow Rights* 12 (Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series 249, 1999), *available at* http://lsr.nellco.org/harvard_olin/249 .
[35] *See* Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641, 1663-1665 (2006).
[36] *See* La Porta et al (1999), *supra* note 19.
[37] *See* Gilson (2006), *supra* note 35, at 1649-1650.
[38] *See* Martin Holmén & Peter Högfeldt, *A Law and Finance Analysis of Initial Public Offerings*, 13 J. OF FIN. INTERMEDIATION 324 (2004), Martin Holmén & Peter Högfeldt, *Pyramidal Discounts, Tunneling or Overinvestment?*, 2 INT. REV. OF FIN. 133 (2009), Alexander Dyck & Luigi Zingales, *Private benefits of control: An international comparison*, 59 J. OF FIN. 537 (2004) and Jonas Agnblad, Erik Berglöf, Peter Högfeldt &

ownership remains an important feature of the corporate environment and has often been supported by the use of control enhancing mechanisms, such as dual class share structures.[39] Nevertheless, empirical studies report relatively low levels of private benefits of control in Sweden – at levels similar to the United States and the United Kingdom, countries generally associated with high levels of dispersed ownership.[40]

In fact, it has also been noted that ownership in the United States may be less dispersed than commonly assumed. Empirical research suggests that a significant portion of publicly listed companies have block holders, or even a single controlling shareholder.[41] Moreover, there are important examples from leading growth companies in the U.S. technology sector of founders retaining control with control enhancing mechanisms at the point of listing.[42] This reflects the notion that governance models based on concentrated ownership remain highly relevant. The life-cycle theory of corporate governance suggests that concentrated ownership may well be characteristic of new innovative companies, as in the cases referred to above, but will give way to other forms of governance as the company matures.[43] Nevertheless, if we accept that only low levels of private benefits of control are permitted in the U.S. institutional environment, then there would seem to be other reasons for maintaining control of a company than the ability of the founders to enrich themselves at the cost of the other shareholders. Consequently, other explanations for differences between corporate governance systems may be warranted.

Block holding has been identified as a corporate governance mechanism for mitigating the collective action problem of shareholders.[44] It has been recognized that there may be a trade-off between the agency problems related to the separation of ownership and control in a diversified shareholder structure and the issues that arise in connection with concentrated ownership.[45] Controlling shareholders can provide an efficient management monitoring function, as they may carry undiversified risk in holding a large position in a single company.[46] The inability of the minority shareholders to challenge the position of the controlling shareholder is compensated for by an alignment of interests based on the illiquid investment of the controlling shareholder. If sufficient restrictions are in place to limit the ability of controlling shareholders to extract private benefits of control through related-party transactions, for example, the structure may well offer a competitive form of ownership.[47] This should also be reflected in corporate governance regulation.

Helena Svancar, *Ownership and Control in Sweden: Strong Owners, Weak Minorities and Social Control* in THE CONTROL OF CORPORATE EUROPE (Fabrizio Barca & Marco Becht, eds., 2001).

[39] *See* Magnus Henrekson & Ulf Jakobson, *The Swedish Corporate Control Model: Convergence, Persistence or Decline?* (IFN Working Paper No. 857, 2011), *available at* http://ssrn.com/abstract=1734149.

[40] Tatiana Nenova, *The Value of Corporate Voting Rights and Control: A Cross-country Analysis*, 68 J. OF FIN. ECON. 325, 348 (2003); *see also* Alexander Dyck & Luigi Zingales (2004), *supra* note 38.

[41] *See* Clifford Holderness, *The Myth of Diffuse Ownership in the United States*, 22 REV. OF FIN. STUDIES 1377 (2007).

[42] *See* Gilson (2006), *supra* note 35, at 1660.

[43] *See* Igor Filatotchev, Steve Toms & Mike Wright, *The Firm's Strategic Dynamics and Corporate Governance Life-cycle*, 2 INT'L J. OF MAN. FIN. 256 (2006).

[44] Marco Becht, Patrick Bolton & Ailsa Roell, *Corporate Governance and Control* 17-21 (ECGI Finance Working Paper 02/2002) *available at* http://ssrn.com/abstract_id=343461.

[45] *See* Ronald J. Gilson & Jeffrey Gordon, *Controlling Controlling Shareholders*, 152 U. PENN. L. REV. 785 (2003).

[46] *See* Becht, Bolton & Roell (2002), *supra* note 44.

[47] Gilson (2006), *supra* note 35, at 1649-1650, 1678-1679.

Empirical studies support the view that concentrated ownership in itself does not necessarily imply inferior corporate performance. In certain regions concentrated ownership has indeed been found to correlate with weaker firm performance,[48] but a number of studies have also found a positive relationship between firm performance and concentrated ownership.[49] In fact, a division between jurisdictions that support a variety of shareholder systems and those that only support concentrated ownership has been suggested.[50] In the former jurisdictions, concentrated ownership is seen as one of many possible efficient governance outcomes supported by the overall legal framework. One important aspect of such jurisdictions is that the legal framework does not allow for high levels of private benefits of control.

B. THE INSTITUTIONAL ENVIRONMENT

Industrial development and political institutions[51] have a significant impact on the development of the structure of corporate ownership and corporate law.[52] In this context concentrated ownership has been seen to reflect the effects of the broader institutional environment. Roe mentions Germany, Italy and Sweden as examples of EU member states with a political and institutional environment that supports concentrated ownership.[53] Roe argues, for example, that in countries with strong labor institutions there is likely to be more pressure for corporate governance institutions that favor employees and less for institutions that support the interests of shareholders. [54]For example, companies are likely to be encouraged to expand to secure employment, even at the cost of profitability, and to avoid down-sizing and taking disruptive risks.[55] In this environment the institutions needed for dispersed ownership to flourish are absent, whereas a controlling shareholder would be in a relatively good position to bargain over surplus and to resist political pressures.[56] Other political economy explanations point out that in states with concentrated ownership a political majority with fewer financial incentives (and more labor-oriented financial interests) may oppose a market-based system related to higher risk taking.[57] The political system in this environment can be expected to favor large shareholders and labor at the cost of smaller investors and will support complementary governance structures – much of which can be observed in EU member states with concentrated ownership. Finally, incumbent industrial and financial interest groups may also seek to affect the development of financial systems based on their interest to restrain competition[58]. Rajan and Zingales argue that it is in incumbents' interest to restrict financial development and the openness of the economy in order to prevent the emergence of competitors. However, globalization has reduced their

---

[48] *See* Claessens et al. (2002), *supra* note 26.
[49] *See* Pedersen & Thomsen (2003), *supra* note 6 and Weiss (2010) *supra* note 20.
[50] *See* Gilson (2006), *supra* note 35, at 1660-1661.
[51] *See* Roe (2000), *supra* note 13 and MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE (2003).
[52] See Lucian A. Bebchuk and Mark J. Roe, *A Theory of Path Dependence in Corporate Governance and Ownership*, 52 STAN. L. REV. 127 (1999).
[53] *See* Mark J. Roe, *The Institutions of Corporate Governance* (Harvard Law School, John M. Olin Center's Program for Corporate Governance Discussion Paper 488, 2004), *available at* http://law.harvard.edu/programs/olin_center/papers/pdf/Roe_488.pdf.
[54] *Id.* at 18.
[55] *Id.* at 18-19.
[56] *Id.* at 19.
[57] *See* Enrico C. Perotti & Ernst-Ludwig von Thadden, *The Political Economy of Dominant Investors* (Tinbergen Institute Discussion Paper 2004-091/2), *available at* http://dare.uva.nl/document/5462.
[58] *See* Raghuram G. Rajan & Luigi Zingales, *The Great Reversals: The Politics of Financial Development in the Twentieth Century*, 69 J. OF FIN. ECON. 5 (2003).

impact on financial markets, resulting in an increase in the development of corporate finance and market-based corporate governance institutions.[59]

C. CONCENTRATED OWNERSHIP AND CORPORATE CONTROL

There has been concern that corporate governance systems based on concentrated ownership have provided inadequate means for the effective monitoring of controlling shareholders. There seems to be a lack of effective mechanisms both to restrict the ability of controlling shareholders to disenfranchise minority shareholders and to challenge the control of incumbent controlling shareholders when they no longer contribute to the enterprise.[60] It has traditionally been argued that monitoring agent behavior can be more effective in an environment of dispersed ownership, where management is accountable to shareholders and monitored by market-based mechanisms, such as hostile takeovers.[61] However, in reality it appears that control is often concentrated and hard to challenge, regardless of the governance and ownership structure.[62] Control is commonly concentrated in the hands of given corporate constituencies, usually management or an owner-entrepreneur, for example; but it rarely rests with outside shareholders.[63] Complementary institutions usually evolve to support the prevalent governance system, further strengthening the influence of the dominant constituencies.[64] For example, it has been argued that legal systems support management control in jurisdictions with a prevalence of dispersed ownership, while shareholder power may be stronger in jurisdictions with a preponderance of concentrated ownership.[65]

As legal systems evolve, the position of the controlling constituents is strengthened in relative terms and even entrenched. It is important to emphasize that the possibility of entrenchment of corporate control is not limited to concentrated ownership. Pacces suggests that the entrenchment of corporate control may be not just a distortion of separation of ownership and control, but rather one of its distinctive features.[66] In other words, entrenchment is not limited to governance systems based on concentrated ownership; it is also a feature of dispersed ownership systems.

The arguments discussed above suggest that concentration of control may be a key characteristic of corporate governance. However, rather than being a means to extract private benefits, control may be a crucial pre-requisite for certain firm-specific investments in an environment of incomplete contracts. In fact, corporate control has also been associated, for example, with the ability to pursue value-maximizing strategies that markets are not fully able to price and where investors might disagree with the entrepreneur on the use of the corporate

---

[59] *Id.*

[60] Becht, Bolton & Roell (2002), *supra* note 44, at 17-21, *see also* Lucian A. Bebchuk, *Efficient and Inefficient Sales of Corporate Control*, 109 Q´LY J. ECON. 957 (1994).

[61] Becht, Bolton & Roell, *supra* note 44, at 12-17.

[62] *See* Alessio M. Pacces, *Control Matters: Law and Economics of Private Benefits of Control* 30 (Rotterdam Institute of Law and Economics, Working Paper 2009/04, 2009), *available at* http://ssrn.com/abstract=1448164.

[63] *See* Hellwig (2000*)*, *supra* note 24, Sofie Cools, *The Real Difference in Corporate Law between the United States and Continental Europe: Distribution of Powers* 64 (Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series, Paper 490, 2004) *available at* http://lsr.nellco.org/harvard_olin/490 .

[64] *See* Bebchuk & Roe (1999), *supra* note 52 and Cools (2004), *supra* note 63.

[65] *See* Cools (2004), *supra* note 63.

[66] *See* ALESSIO M. PACCES, RETHINKING CORPORATE GOVERNANCE – THE LAW AND ECONOMICS OF CONTROL POWERS 14, 411-413 (2012).

assets.[67] As a result, it is possible that the controlling constituent prioritizes control rights over cash-flow rights, whereas investors take the opposite view, allowing for the parties to seek an optimal balance in the form of the financial structure of the corporation through bargaining. This suggests that approaching corporate governance from the perspective of bargaining may provide additional insights into the relationship between corporate constituencies. It also suggests that for the purposes of corporate governance regulation it may be just as important to recognize the rights of the controlling constituents (or agents) as it is to acknowledge the need to protect minority shareholders.[68]

The underlying causes of the structure of ownership are complex. Nevertheless, it seems that concentrated ownership may well be an efficient form of ownership and can provide a competitive basis for corporate governance. It also seems clear that there may be other reasons for maintaining control than the ability to extract private benefits. In this regard, agency theory and the notion of the separation of ownership and control may fail to fully describe the dynamics of the relationship between corporate constituents in the modern corporation in the context of an evolving corporate environment. It is possible that a better understanding of the underlying causes of different forms of corporate ownership may still be needed.

III. Bargaining and Corporate Governance

The nature of the corporation cannot be separated from the nature of the underlying business enterprise. It has been argued that the nature of the corporation is changing together with the evolution of the prevalent forms of enterprise. If the dominant features of business change, this may have an effect both on the relationships between corporate constituencies and on corporate governance. For example, it has been argued that the importance of innovative enterprise and human capital as a basis for enterprise has increased relative to the importance of capital and ownership of physical assets. Moreover, decision making may no longer be concentrated at the top of the organization.[69] These factors are bound to affect corporate governance choices. Zingales argues that the boundaries of the firm are less stable and can easily be affected by financing and governance choices.[70] These developments should also be taken into account in corporate governance regulation when considering the basis for regulating the relationships between corporate constituencies.

Agency theory has focused on principal-agent relationships among corporate constituencies and on the monitoring of agent performance. A key concern has been how to overcome agency problems, incentivize agents and align their interests with those of the principals. However, an important element that agency theory fails to address directly is the relationship between financial structure and corporate governance.[71] The financial contracting literature and theories related to the incompleteness of contracts introduce new elements that connect the structure of corporate finance with corporate governance and the allocation of control rights.[72] However, these factors may be insufficiently reflected in corporate governance regulation. This section outlines the financial contracting approach to corporate governance and how it reflects the dynamic nature of the relationship between entrepreneurs and

[67] *See* Goshen & Hamdani (2013), *supra* note 11.
[68] *Id.* at 1.
[69] Zingales (2000), *supra* note 14, at 37.
[70] *Id.* at 3.
[71] *See* Oliver E. Williamson, *Corporate Finance and Corporate Governance*, 43 J. OF FIN. 567 (1988).
[72] *See* Hart (2001), *supra* note 21.

investors. The purpose of this section is to identify possible alternative approaches to the role of controlling shareholders to be used as a basis in corporate governance regulation.

A. FROM AGENCY THEORY TO FINANCIAL CONTRACTING AND BEYOND

Agency theory provides a basis for understanding the relationships between different actors involved in economic activity.[73] The idealized "firm" has been viewed as a "nexus of contracts" for corporate constituencies when regulating agency relationships in relation to a business enterprise.[74] In their approach, Jensen & Meckling view the "firm" as a legal fiction that provides the axis for contractually arranging the conflicting objectives of these actors for the purposes of economic activity.[75] As outside equity investment is introduced, agency costs will be generated as the interests of managers and outside investors begin to diverge. This line of argument results in support for the separation of ownership and control and a focus on management monitoring as the main function of corporate governance.

In an environment where the relative importance of capital is emphasized, the position of investors (including shareholders) as principals is underlined at the cost of the entrepreneurs deemed to be acting as agents. Much of the focus in corporate governance reregulation has been on effective monitoring and incentives to ensure that agents promote the interests of principals. In the corporate context, it sometimes seems that agents have been likened to employees that can be dismissed at will, which, of course, is not what agency theory necessarily suggests. A definition of the relationship between corporate constituencies based on agency theory alone may reflect just one of many bargaining outcomes, and may fail to reflect the dynamic nature of these relationships characteristic to the modern corporation and an evolving corporate environment.

While agency theory has provided major contributions to the theory of the firm, it has been supplemented by other approaches, including transaction cost economics and the theory of property-rights. Scholars have argued that while agency theory provides a framework for understanding problems related to the relationships between corporate constituencies, it does not fully explain the financial structure of the corporation. Hart observes, for example, that when applying agency theory to the corporate context, the main focus seems to be on monitoring and aligning the interests of agents with those of principals, while there seems to be less focus on explaining the financial structure of the corporation.[76] Williamson emphasizes the relationship between the structure of corporate finance and corporate governance, claiming that the type of financial instrument and resulting governance system should be based on the characteristics of the specific project or transaction.[77]

In property rights theory, a firm is defined according to the assets it possesses, with ownership conferring residual rights of control over these assets.[78] The specificity of assets in a corporation and the further realization that ex ante contracting among corporate constituencies is necessarily incomplete puts an emphasis on the allocation of decision rights with regard to

[73] *See* Michael Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownershup Structure*, 3 JFE 305 (1976).
[74] *Id.*
[75] *Id.* at 314.
[76] Hart (2001) *supra* note 21, at 7 and 9.
[77] *See* Williamson (1988), *supra* note 71.
[78] *See* Hart & Moore (1990), *supra* note 23.

how corporate assets are used and, importantly, separates "access" from "ownership."[79] There has been much research on how decision-making rights should be optimally allocated between managers (or entrepreneurs), on the one hand, and investors (or providers of financing), on the other.[80]

It is also possible to approach the corporation and corporate governance as a framework for continuous or at least recurring bargaining among self-interested actors with varied interests who can obtain benefits from mutual cooperation.[81] This approach has its origins in game theory – but here it is applied to a less-stylized, unstable environment with multiple parties.[82] Bargaining occurs in, and is affected by, the broader institutional environment, involving market institutions and processes, the industrial and political environment and formal and social norms.[83] With respect to corporate ownership and control, bargaining within these parameters can result in multiple equilibria, including governance models with concentrated ownership.[84]

Generally, multiple parties are deemed to be involved in bargaining over corporate governance, including investors, management and employees.[85] With respect to investors, the role of shareholders has often been emphasized, but debt investors also have a considerable interest in the corporation, of course.[86] Bargaining can take the form of explicit or implicit contracts that parties may seek to renegotiate from time to time as their relative bargaining power evolves. The relative bargaining power among corporate constituencies can change as a result of technological or industrial changes, for example, or through political developments and the introduction of new regulation. Bargaining, then, does not need to be direct; instead, corporate constituencies can, for example, affect internal relationships through the political system.

A relevant prerequisite for bargaining is the fact that contracts are necessarily incomplete, as discussed above, and it is generally impossible to fully regulate the relationships among corporate constituencies *ex ante*. When an investor has made a significant firm-specific investment (be it a shareholder, debt holder, manager or employee) it is difficult to withdraw, and thus it becomes less liquid. Once an equity investment is made, for example, it may not be possible to withdraw it, and the investor is dependent on the continued performance of other constituencies. Similarly, employees will be more dependent on a specific corporation once they have invested in firm-specific skills that may be difficult to take elsewhere. Other constituencies may look to take advantage of this and attempt to renegotiate the terms of their respective investments as their relative bargaining power changes. Investors will be aware of this, of course, and require *ex ante* guarantees to protect their initial investment.[87] However, as contracts are necessarily incomplete (and as the alternatives available to investors are likely

---

[79] *Id.* at 1121.
[80] *Id.* at 1121-1122 and 1149-1151.
[81] *See* Aoki (2001), Coffee (1989-1990) and Utset (1995), *supra* note 12.
[82] Coffee (1989-1990), *supra* note 12, at 1497.
[83] Masahiko Aoki & Gregory Jackson, *Understanding an Emergent Diversity of Corporate Governance and Organizational Architecture: An Essentiality-Based Analysis* 3 (SIEPR Discussion Paper 07-19, 2007), *available at* http://www-siepr.stanford.edu/repec/sip/07-019.pdf.
[84] MASAHIKO AOKI, CORPORATIONS IN EVOLVING DIVERSITY 33-35 (2010).
[85] *See* Coffee (1989-1990), supra note 12, Aoki (2010), *supra* note 84, at 19-35.
[86] OLIVER HART, FIRMS, CONTRACTS AND FINANCIAL STRUCTURE 8, 118-120 (1995).
[87] *See* Luigi Zingales, *Corporate Governance* 16 (NBER Working Paper 6309, 1997), *available at* http://www.nber.org/papers/w6309 .

to have the same characteristics in an environment of incomplete contracts) there will be room for such renegotiations.[88]

The structure of corporate finance and the framework of corporate governance provide the building blocks for bargaining. In this context, the corporation and corporate finance can be approached from the perspective of financial contracting.[89] In simple terms, financial contracting in the corporate context can be seen as an understanding between an entrepreneur with an idea but no funds and an investor with funds but no idea.[90] The structure of corporate finance and the corporate governance of a given corporation are the result of bargaining between these actors. From the perspective of financial contracting, much of corporate governance relates to how entrepreneurs and investors agree on the terms of corporate financing. Different forms of capital structure, i.e., different corporate finance and corporate governance solutions, reflect the different outcomes of bargaining between these constituencies. The relationship between those in need of financing for their business enterprise and the providers of that financing is a core element of corporate governance.[91] It is in this respect that this approach may be useful for analyzing concentrated ownership, as controlling shareholders can be seen as entrepreneurs and concentrated ownership as one outcome of bargaining. [92]Control enhancing mechanisms can be similarly understood as the result of negotiations between the entrepreneur and investors, for example.

In financial contracting theory, the entrepreneur negotiates cash flow and governance rights with the providers of financing.[93] As discussed, different types of financial instruments, i.e., equity, debt and convertibles, are the basic building blocks of corporate finance and corporate governance. [94]The structure of corporate finance sets the framework for ex-post bargaining over control. For example, debt-financing generally allows the entrepreneur to maintain control. However, higher levels of debt increase the risk of default, with the result, typically, that control will be passed to the investors. Equity-financing, on the other hand, generally provides control rights to the investors. Financial instruments with contingent control rights, such as convertible debt, provide a further model of allocating governance rights, in that control is transferred upon a triggering event typically linked to the performance of the enterprise.

Different bundles of governance rights and cash-flow rights attach to different bundles of financial instruments. Governance rights can be divided in many different ways, including on the basis of the party entitled to take governance decisions, the types of decisions or specific contingencies.[95] Cash-flow rights, on the other hand, can be divided on the basis of duration (debt with different maturity or equity with indefinite maturity) or whether they are fixed (debt), residual (equity) or a combination of the two. By agreeing on the use and allocation of different combinations of financial instruments, entrepreneurs and investors can create unique bundles of cash-flow and governance rights.

[88] *Id.* at 3.
[89] *See* Hart (1995), *supra* note 86.
[90] Hart (2001), *supra* note 21, at 1.
[91] *See* Andrei Shleifer & Robert W. Vishny, A Survey of Corporate Governance, 52 J. OF FIN. 737, 737 (1997).
[92] *See* Hart (2001), *supra* note 21.
[93] *Id.* at 1-2, 10-12 and Goshen & Hamdani (2013), *supra* note 11.
[94] *See* Hart (2001), *supra* note 21.
[95] Goshen & Hamdani (2013), *supra* note 11, at 583-586.

In this context, it is important to further recognize that bargaining is on-going and involves multiple participants. Moreover, bargaining does not occur in a vacuum and is affected by the relevant institutional environment with which participants interact, and also by which participants can form coalitions for increased bargaining power.[96] The participation of employees, for example, can occur through the political system, as will be discussed in more detail below.

B. BARGAINING OVER CORPORATE CONTROL

1. Approaches to Corporate Governance

The well-known definition of corporate governance provided by Shleifer & Vishny states that "corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment."[97] Shleifer and Vishny emphasize that production capital is specified; i.e., it is committed to the enterprise (resulting in sunk costs). When different constituents consider firm-specific investments of capital or labor, thus resulting in sunk costs, there must be sufficient assurance that they will be reimbursed. Corporate governance mechanisms are intended to provide that assurance.[98]

Pursuant to the definition above, the goal of corporate governance mechanisms is to provide the basis for an optimal balance in the terms and conditions of different types of contributions of production capital (equity, debt, labor etc.) at any given time. Shleifer & Vishny's definition suggests that corporate governance arrangements are much like contractual arrangements or covenants that are negotiated among the parties and affected by the risks and returns involved. However, it is commonly acknowledged that corporate governance is a more complex phenomenon that cannot easily be defined on the basis of a purely contractual approach. Such a definition is particularly difficult where entrepreneurial aspects are involved and there is disagreement on the potential levels of future cash-flows. At best, theories related to the costs of contracting simply suggest that the implicit contracts underlying the relationships between corporate constituents are incomplete.[99] Corporate governance provides the means and mechanisms by which potential conflicts of interest among different corporate constituencies are resolved. It is important to recognize, however, that the dynamics of corporate governance can change. Corporate constituents can seek to renegotiate these contracts if their bargaining power increases over time, with each party seeking to increase its stake from the income of the enterprise.[100]

Shleifer & Vishny's definition has often been used as the basis for working with the allocative aspects of governance. A broader version of the definition has been provided by Zingales, whereby corporate governance is the "set of conditions that shapes the ex post bargaining over the quasi rents generated by a firm."[101] Zingales emphasizes the incompleteness of contracts and recognizes the interests of all parties who are mutually specialized and have made firm-specific investments, i.e., shareholders, employees, suppliers and customers.[102] As

[96] See Aoki (2001), *supra* note 12, at 287-291; Coffee, *supra* note 12; *see also* PETER GOUREVITCH & JAMES SHINN, POLITICAL POWER AND CORPORATE CONTROL (2005).
[97] Shleifer & Vishny (1997), *supra* note 91, at 737.
[98] *Id.* at 738.
[99] *See* Philippe Aghion & Patrick Bolton, *An Incomplete Contracts Approach to Financial Contracting*, 59 R. ECON. STUDIES 473 (1992).
[100] Utset (1994), *supra* note 12, at 609.
[101] *See* Zingales (1997), *supra* note 87.
[102] *Id.* at 5.

assets become specialized their value outside that context decreases. This has important implications for the efficient allocation of control rights. Zingales argues that, as a result, residual rights of control should be allocated to a "group of agents who need to protect their investment against ex post expropriation, but who have little control over how much the asset is specialized."[103] This approach has important implications for corporate governance mechanisms. Zingales claims that governance mechanisms, including allocation of ownership, financial structure, organizational structure, product market competition and takeovers, can be seen as institutions affecting the process of how quasi rents are distributed. This perspective suggests that the firm is a complex structure[104] and expands corporate governance to cover a broader range of norms and circumstances. Moreover, the relationships between corporate constituencies are defined not in hierarchical terms but rather in terms of their relative dependency. A further aspect of Zingales' analysis is that these relationships are not in an equilibrium[105] but evolve with technological, political and institutional developments. Thus, the group of agents whose firm-specific investments require protection will also change over time.

I shall first consider the basis for bargaining over corporate governance from the perspective of financial contracting and will then, in the next section, turn to some factors affecting the dynamics of that bargaining.

2. Bargaining over Corporate Governance

As discussed above, corporate governance can be approached as a broad framework for bargaining over the terms of corporate finance in which entrepreneurs and investors agree on the allocation of control rights and cash-flow rights with the aim of finding the best outcome to meet the specific requirements and priorities of each party. It is important to note, however, that control rights and cash-flow rights may not be symmetrically valued by these parties.[106] This allows for increased value to be obtained through bargaining. The different priorities of the actors and their relative valuation of control and cash-flow rights provide the basis for bargaining over how cash-flow and governance rights are allocated between them.

From the entrepreneur's perspective, the corporation can be seen as a financing vehicle for a business opportunity with a broad range of financial instruments with varying terms and conditions and other qualities. The entrepreneur commits his management skill and his personal assets to the enterprise and, if supported by the institutional environment, uses a controlling stake in a publicly held corporation as the organizational form for such enterprise to obtain a desirable financial structure. The entrepreneur bargains the terms of financing with relevant providers – including other shareholders, and the structure of corporate finance represents the outcome of this bargaining.

Corporate governance rules set the framework for the amount and type of discretion an entrepreneur has over the use of corporate assets. The corporate governance framework sets the limits on control in relation to the ability to manage day-to-day operations, obtaining and agreeing terms of financing, and the ability to take corporate decisions affecting the rights of corporate constituencies. These controls limit management control rights and, to an extent,

[103] *Id.* at 13.
[104] *See* Bruno Deffains & Dominique M. Demougin, *Governance: Who Controls Matters* (SFB 649 Discussion Paper No 53, 2006), *available at* http://hdl.handle.net/10419/25136.
[105] Aoki (2010), *supra* note 84, at 13-14.
[106] Goshen & Hamdani (2013), *supra* note 11, at 585-586.

minimize self-serving behavior by the agent.[107] However, they may also restrict business decisions aimed at superior performance. Control rights and autonomy are valued by the entrepreneur, as they facilitate decision making for maximizing value. Investors, however, will require increased returns to compensate for the possibility that actions are taken that they oppose. The entrepreneur will seek to agree on the terms of corporate governance to balance autonomy with the cost of capital.

For the entrepreneur it is important to maintain control of the business enterprise – i.e., to be able to decide upon the strategy of the corporation and how the corporation's assets are ultimately used in order to maximize profits. As the parties involved have asymmetric information, there is the possibility of disagreement between investors and the entrepreneur over the value of the corporation or the steps required to maximize that value. Consequently, the primary motivation of the entrepreneur for maintaining control of the corporation may not be the extraction of private benefits of control, and the entrepreneur may not rely on self-dealing to capture returns. Rather, the entrepreneur may anticipate that disagreements can arise as to the best use of the corporation's resources to maximize profits.[108] For investors the protection of cash-flow rights may be the primary interest. Investors may allow the entrepreneur to take operative decisions but want to protect their cash-flow rights by having a veto with regard to corporate decisions that could have a significant impact on those rights (or an exit right in corresponding circumstances). In bargaining over corporate finance, the entrepreneur can be expected to require a level of control allowing for the pursuit of the business enterprise but should be able to commit to sharing control in other matters and give guarantees to other shareholders with regard to the return of their investment. The different priorities in this regard reduce the conflict between the interests of entrepreneurs and investors and can allow for efficient bargaining results.

3. The Political Environment

Politics and corporate governance systems are interlinked.[109] Corporations and the way they are governed are of considerable economic importance. Corporate governance has a significant effect on the preconditions for the creation of wealth and economic growth, as well as on the distribution of the cash flows and profits from corporate enterprise. It is but natural that corporate governance should have considerable political implications, as key corporate constituencies agree and renegotiate their relationships through the political framework.[110] Corporate constituencies are also interest groups that can use political means to further their own interests. In fact, a two-way causation has been identified between politics and corporate governance, so that they can be said to co-evolve.[111] Different political conditions impact the structure of corporate governance systems, while different corporate governance systems can similarly cause various political reactions.[112] It has been argued that political approaches to corporate governance have demonstrated that corporate governance evolves "through a

---

[107] Arnoud W. A. Boot, Radhakrishnan Gopalan & Anjan V. Thakor, *The Entrepreneur's Choice between Private and Public Ownership*, 61 J. OF FIN. 803, 804 (2006).
[108] *Id.* at 809.
[109] *See* Marianna Belloc & Ugo Pagano, Co-Evolution of Politics and Corporate Governance, 29 INT'L. R. OF LAW AND ECON. 106 (2009).
[110] *See* Roe (2000), *supra* note 13; *see also* Roe (2003), *supra* note 51.
[111] Ugo Pagano, *The Evolution of the American Corporation and Global Organizational Biodiversity*, 35 SEATTLE U. L. R. 1271, 1272 (2012).
[112] *Id.*

dynamic process of competing interests and competing interpretations of institutionalized norms, processes shaped by, but not fully determined by, political institutions."[113]

The political economy sets the broader parameters for feasible regulatory outcomes. Within these parameters, the public choice literature identifies a "market for regulation," where regulatory changes are the result of bargaining among relevant constituencies, including market participants, regulatory agencies and politicians.[114] The political economy of corporate governance is generally analyzed in relation to how the respective interests of different corporate constituencies are balanced in relative terms. Shareholders, management and employees are often identified as the main corporate constituencies in this regard. Creditors and, with the increasing political interest in corporations, increasingly tax payers at large are other groups with interests in corporate governance that they enforce through policy decisions and regulation. Depending on the structure of the economy and the political system, different constituencies may have different bargaining power, resulting in a variety of corporate governance models – some reflecting the pre-eminence of shareholder interest and others a more continental structure reflecting labor and creditor interests, for example.

This study considers the implications of the above for corporate governance in connection with concentrated ownership. The study argues that entrepreneurs, such as controlling shareholders, should be prepared to share control in matters that do not challenge their right to control corporate strategy or their property rights. This approach may allow a distinction to be made between corporate governance mechanisms that support control rights to protect firm-specific investments from an entrepreneurial stand point and those which reflect the extraction of private benefits and the entrenchment of control. This should be beneficial for the development of corporate governance regulation for environments with concentrated ownership. The findings of the study have implications for regulatory strategies in corporate governance and for assessing the quality of corporate governance mechanisms in an environment of concentrated ownership.

IV. THE DYNAMICS OF BARGAINING

It is important to recognize that a broad range of norms and circumstances affects the use of different financial instruments and defines the terms of corporate governance and corporate control. Bargaining over the structure of corporate finance and corporate governance forms the basis for the relationship between the different constituencies, but that relationship is affected by the broader institutional environment, and changes in that environment necessarily affect the terms of corporate governance and control as well. The study now turns to how the institutional environment affects the dynamics of bargaining and how this might be reflected in regulatory approaches related to corporate governance.

A. INTRODUCTION

The allocation of income or profits is generally based on the result of ex-ante bargaining between the entrepreneur and other providers of financing or means of production. It might be assumed that in each case the structure of ownership and control is optimal as a result of

---

[113] Ruth V. Aquilera & Gregory Jackson, *Comparative and International Corporate Governance,* THE ACADEMY OF MANAGEMENT ANNALS, 4:1, 485, 517 (2010).

[114] *See* Sam Peltzman, *Towards a More General Theory of Regulation*, 19 J. OF LAW AND ECON. 211 (1976), and George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. OF ECON. AND MANAGEMENT SCIENCE 137 (1971).

market-based contracting. Indeed, some scholars have argued that the structure of corporate ownership can be expected to vary based on value maximization.[115] For instance, Demsetz and Villalonga argue that the "ownership structure that emerges, whether concentrated or diffuse, ought to be influenced by the profit-maximizing interests of shareholders, so that, as a result, there should be no systematic relation between variations in ownership structure and variations in firm performance."[116] These scholars believe there is sufficient empirical support for the view that "the market succeeds in bringing forth ownership structures…that are of approximate appropriateness for the firms they serve."[117]

Property rights theory is also concerned with the optimal allocation of control rights and how they can be reallocated between the entrepreneur and investors. According to Aghion & Bolton, for example, the entrepreneur should have control rights when the firm has high earnings and its product is selling, whereas investors should be given increased control rights in the opposite case.[118] The optimal allocation of control rights should also be reflected in the cost of financing, with higher levels of control maintained by the entrepreneur raising that cost. However, lower levels of control will decrease the willingness of the entrepreneur to make firm-specific investments in the enterprise. Often maintaining some level of contingent control rights allows investors to make monetary commitments at a reasonable cost to the entrepreneur. If the investment is unsuccessful, a change in control rights can be triggered by an event that can be agreed ex ante (i.e., by poor performance), and investors can decide again how their investments should best be used. Markets should be able to set the terms of the triggering event, as it should be driven by the cost of financing.

However, bargaining over corporate control does not occur in a vacuum. Industrial and historical developments and the political aspects of corporate governance have a considerable impact on corporate governance outcomes.[119] This affects the types of financial instruments that are used and the preferred financial and governance structure of the corporation. The institutional environment may favor a certain structure of corporate ownership or a certain corporate governance outcome, for example. As was earlier mentioned, it is possible that concentrated ownership is an effective governance model in certain environments. Moreover, the corporate form in itself also affects the terms of bargaining. The firm may be a "nexus of contracts," but the actual legally regulated corporate form introduces externalities to the bargain, resulting in a compromise between freedom of contract and the liquidity of the investment. As a result, corporate governance outcomes may not always be optimal from the perspective of value maximization – at least in the long term as the political economy evolves.

In this section I briefly discuss the externalities that affect bargaining over corporate control and the implications they may have for the need for regulatory intervention.

B. The Institutional and Political Environment

Goshen & Hamdani emphasize that the variation in corporate governance arrangements, as well as in forms of corporate ownership, can be seen to represent the different outcomes of negotiations over the terms of corporate finance.[120] Dispersed ownership, concentrated

---

[115] *See* Demsetz & Lehn (1985), *supra* note 6.
[116] Demsetz & Villalonga (2001), *supra* note 6, at 210.
[117] *Id.* at 231.
[118] Aghion & Bolton (1992), *supra* note 99, at 490-492.
[119] *See* Roe (2004), *supra* note 53.
[120] Goshen & Hamdani (2013), *supra* note 11, 586-593.

ownership and different capital structures with different debt or equity positions are examples of such outcomes. These outcomes are affected by the relative value given to control rights and cash-flow rights by each party, by the supply and demand of different forms of financing for the enterprise and the resulting relative bargaining power of the constituencies, as well as by the industrial and institutional environment, which may favor specific corporate governance or financing structures. The type of industry in which the enterprise is active may also affect the type of ownership and governance that is best adapted to this environment. The institutional environment can be further shaped by externalities, such as the industrial or historical development of business, and it is also affected by path dependence.

The prevalence of different structures of corporate ownership and control can be seen as the outcome of historical and industrial developments.[121] For example, in countries where labor interests are strong, the institutions needed for dispersed ownership to develop may be absent; in contrast, controlling shareholders are often in a good position to bargain with labor and to resist political pressures.[122] Thus, in relative terms, this environment favors a choice of corporate governance systems based on concentrated ownership. It has also been argued that in markets with concentrated ownership a political majority with fewer financial incentives (and more labor-oriented financial interests) may oppose a market-based system related to higher risk taking.[123] In this environment the outcome of the political system can be expected to favor large shareholders and labor, which have undiversified risk positions, at the cost of smaller investors. Complementary governance structures can then be expected to emerge.

To promote their interests, corporate constituencies may form coalitions with other constituencies. Several different outcomes can result from such coalitions, depending on the political economy. A conflict is often seen to emerge between shareholders and labor, for example, with management collaborating with shareholders. When investors are politically dominant, the model leads to strong minority protection and dispersed ownership. On the other hand, when employees are politically dominant, there will be pressure for higher salaries and job security at the cost of profits. This latter model will typically result in a concentrated ownership structure.[124] Coalitions can also be formed between shareholders and employees to constrain managerial agency costs, with, for example, employees supporting shareholders with regard to corporate power in return for security. The loyalties of corporate constituencies are not necessarily stable and can change for opportunistic reasons,[125] or as the political economy evolves. For example, the preferences of labor can be affected by changes in the funding of pension systems.[126]

Nevertheless, the institutional environment may favor a specific structure of corporate ownership and control in relative terms. Thus, the choices with regard to corporate ownership are in reality limited as corporations are established and develop. Once a given structure of corporate governance has been established, it is likely to be reinforced.[127] Bebchuk and Roe suggest that the sunk costs, externalities and complementarities caused by initial choices

---

[121] *See* Roe (2000), *supra* note 13, Roe (2003), *supra* note 51 and Bebchuk & Roe (1999), *supra* note 52.
[122] *See* Roe (2004), *supra* note 53, at 18.
[123] *See* Enrico C. Perotti & Ernst-Ludwig von Thadden, *The Political Economy of Dominant Investors* (Tinbergen Institute Discussion Paper 2004-091/2), *available at* http://dare.uva.nl/document/5462.
[124] Roe (2004), *supra* note 53, at 18-19.
[125] See Coffee (1989-1990), *supra* note 12, at 1531-1538.
[126] Gourevitch & Shinn (2005), *supra* note 96, at 215.
[127] *See* DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE (1990).

increase the cost of alternative structures. [128] Existing structures may also persist due to rent-seeking by controlling constituencies. It is important to recognize the self-reinforcing nature of the structure of corporate ownership and its relationship to the applicable regulatory framework in initiatives to develop corporate governance regulation. This underlines the importance of addressing corporate governance issues in the context of existing structures of ownership and control. It is important, then, that corporate governance regulation be adapted to the characteristics of the relevant institutional environment.

C. THE CORPORATE FORM

The corporate form in itself affects bargaining between the entrepreneur and external investors. However, the corporation does not necessarily always provide the ideal framework for balancing the interests of entrepreneurs and investors with respect to a specific enterprise. Bespoke contracts could well provide a more accurate reflection of the interests of these constituencies. The listed corporation, for example, is subject to endogenous and often standardized corporate governance requirements, which may or may not provide an optimal balance between these interests. Company law in general can also be too generic and untailored to the specific requirements of each enterprise.

Corporate law and corporate governance regulation provide different (and in a sense arbitrary) thresholds where financial instruments are linked to special governance rights. For example, it is often the case that the board can be nominated by a simple majority of votes at a general meeting of shareholders, while certain corporate transactions (such as statutory mergers, where available) may require the support of different qualified majorities. Deviating from these rules is often costly and sometimes even impossible in the context of public corporations. Moreover, governance rights are not directly allocated on a pro rata basis, but include option value where an investor holding bundles of financial instruments with a specific set of governance rights is able to take certain corporate decisions or veto them. These thresholds may be standardized and thus fail to reflect the optimal solution in each case.

The liquidity provided by the standardized terms offered by company law may, however, compensate for possible sup-optimal governance solutions. Ultimately, the market should be able to price the potential risks and returns of investments made on the terms provided by the applicable corporate governance framework. Contracting is also costly, and the corporate form may nevertheless provide a cost-efficient default platform for arranging economic relationships among corporate constituencies with respect to the enterprise. The entrepreneur may balance the need for bespoke contracting against the liquidity provided by solutions prevalent in the market. Nevertheless, the corporate form does affect bargaining, as will be discussed in more detail below.

1. Lock-in of Assets in the Corporation

Much effort has been directed to defining and explaining the existence and development of the corporation. As an entity, the corporation may be a legal fiction, but it has proved an excellent structure for organizing economic activity, for overcoming coordination problems and conflicts of interest among economic actors and for contributing to economic growth. Compared to the contractual fiction of the conceptual "firm," the "corporation" can be defined

[128] *See* Bebchuk & Roe (1999), *supra* note 52.

as a legally regulated platform for economic activity. The corporation can be seen as a legal shell that has defined claims on the underlying economic activity.[129] While corporations are subject to national regulation that may vary among different jurisdictions, the corporations generally discussed in the context of international corporate governance research have certain common features that are relevant for the purposes of a more general evaluation.[130] Corporations are generally independent legal entities that hold distinct assets and liabilities. Corporations are also generally characterized by a shareholder structure, where equity investment is made in the form of shares and where ownership is formally separated from the control and management of the corporation. Ultimately, the rights and obligations of providers of financing rest on contractual terms and conditions based on mandatory default rules (in company law) or actual investment agreements (articles of association, terms of specific investment instruments).

One of the key characteristics of the corporation is its independent legal personality and the fact that its assets and liabilities are separated from those of investors. This separation results in the lock-in of capital injected into the corporation, which, is deemed an important factor in its institutional success.[131] While shareholders enjoy limited liability, it is equally important that the assets of the corporation are protected from the creditors of the shareholders and that shareholders are prevented from withdrawing their share of the corporate assets at will. The lock-in serves to provide comfort for creditors and other parties dealing with the corporation. However, it also allows for a re-bargaining of the terms of investment, as investors have made illiquid, firm-specific investments resulting in heavy sunk costs. In other words, in reality the shareholder cannot easily withdraw his or her investment at will.

The transferability and fungibility of shares are also important features of a corporation. For example, governance and cash-flow rights are related to shares and are not linked to the party holding the shares. Shareholders hold shares that give them certain cash-flow and governance rights based on company law and the articles of association of the company. These rights are balanced, based in part on the legal framework, with the interests of other constituencies. The framework by which this balance is regulated is the central focus area of corporate governance. While the other characteristics of corporations are fairly similar around the world, the allocation of corporate control and authority can be organized in a variety of ways.[132]

Shareholders are sometimes defined as the "owners" of the corporation. For the purposes of this study, and more generally, it seems important to challenge this notion. As discussed, shareholders merely have certain specific governance rights based on the shares they hold, as well as certain residual cash-flow rights; but they cannot be said to "own" the company. In this regard, the lock-in of the capital injected by shareholders and the fungibility of shares are important features that allow for the re-bargaining of the terms of corporate finance as the relative bargaining power of different corporate constituencies evolves over time. This bargaining power is reflected, among others, in corporate governance regulation and in how

[129] *See* Deffains & Demougin (2006), *supra* note 104.

[130] John Armour, Henry Hansmann & Reinier Kraakman, *What is Corporate Law?* 1 in Kraakman et al. (2004), *supra* note 32, at 5-16.

[131] *See* Henry Hansmann, Reinier Kraakman & Richard Squire, *Law and the Rise of the Firm*, 119 HARV. L. REV. 1333 (2006) and Margareth Blair & Lynn A. Stout, *Specific Investment and Corporate Law*, 7 EUR. BUS. ORG. L. REV. 473, 495–496 (2006).

[132] ROGER M. BARKER, CORPORATE GOVERNANCE, COMPETITION, AND POLITICAL PARTIES 3 (2010).

such regulation changes over time. It is for this reason that it is important to understand the dynamics of corporate governance.

2. Public and Private Ownership

The listed corporation often provides the best available liquidity for external investments, resulting in cost-efficient financing. However, this corporate form often also entails standardized corporate governance solutions that can be affected by externalities. Boot, Gopalan & Thakor argue that entrepreneurs may avoid public ownership with externally fixed corporate governance regimes, choosing instead private ownership structure, where they are able to tailor the corporate governance framework to their needs together with investors.[133] The corporate governance structures applied to publicly listed corporations are, to some extent, externally given and based, for instance, on statutes or stock exchange rules. Corporate governance structures in public corporations can also be subject to regulatory intervention based on political agendas. Moreover, these structures may be fixed and untailored to the kind of precise trade-off desired by the entrepreneur.[134] On the other hand, a public ownership structure provides increased liquidity, generally resulting in lower costs of capital.

Boot, Gopalan & Thakor argue that the choice of ownership structure depends on the stringency of corporate governance regimes. If corporate governance is particularly lax and investor protection is low, investors may require extremely high returns. Under such circumstances, entrepreneurs tend to prefer private ownership with a small number investors where corporate governance is largely contractual. When corporate governance for publicly traded corporations is overly stringent, the entrepreneur's autonomy will be excessively limited, and private ownership will again be preferred. Other factors affecting choices of ownership structure include the increased cost of capital for private ownership structures and the likelihood of disagreement between the entrepreneur and the investors.

For the purposes of this study, the above emphasizes that the relationships between corporate constituencies are affected by a variety of external factors and that the outcomes of bargaining are incomplete. This has important implications for corporate governance regulation. It cannot be assumed that the bases of the relationships between corporate constituencies are static; thus it remains important to address how these relationships develop.

D. THE CONCENTRATION OF CORPORATE CONTROL

Many of the corporate governance mechanisms used to avoid the concentration and entrenchment of control may be less effective than assumed – regardless of the structure of ownership. For example, researchers and regulators have voiced concern that shareholders are relatively powerless in the United States.[135] For some time, this concern has focused on the central role of the board of directors, and it has been argued that instead of displaying shareholder primacy, U.S. companies with dispersed ownership are in fact controlled by the board – albeit in the interest of shareholders.[136] For example, boards of directors are deemed to have a considerable level of independence with regard to corporate decision making,

---

[133] *See* Boot, Gopalan & Thakor (2006), *supra* note 107.
[134] *Id.*
[135] Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005).
[136] *See* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW.U.L.REV. 547 (2002-203).

without having to refer matters to shareholders.[137] Furthermore, in matters where shareholders are allowed a voice, directors have often been given a veto-right.[138] It has been assumed, however, that there are effective market-based mechanisms in place whereby the performance of directors and management is monitored.

More recently it has nevertheless been argued that the monitoring mechanisms assumed to police the board and management are not functioning as intended.[139] For example, the hostile takeover is no longer thought to provide the management monitoring function it was once believed to perform. Poor performance reflected in a lower share price is assumed to result in a proposal to change management through a public takeover. In reality, however, the mechanism seldom performs this function, due to institutional entrenchment by management.[140] In contrast, it seems that management has means of maintaining control, while shareholders have clear disincentives to challenge incumbent management.[141]

It has been noted that the allocation of legal powers reflects dominant ownership structures, which provides a further reason why external monitoring mechanisms may be less efficient than assumed. For example, the structure of corporate law may provide an advantage to constituents representing the prevalent structure of ownership, and a relative disadvantage to other constituents in the pursuit of their interests through the regulatory framework. In other words, corporate law has evolved to favor the interests of dominant constituencies. Company law may provide monitoring mechanisms that, for example, insufficiently take into account the collective action problems associated with a diversified and dispersed shareholder base. Moreover, the balance between the interests of the principal and the agent may not provide sufficient incentives for efficient monitoring.

Differences between the allocation of corporate legal authority in the United States and in certain EU member states with concentrated ownership may provide an example in this regard.[142] Cools has observed that under Delaware corporate law the allocation of legal powers favors directors and provides only limited avenues for shareholders to affect corporate matters. When founders in Delaware companies raise further equity financing, they do not need to retain high equity stakes to maintain control as long as they have ensured their representation on the board. This balance of legal authority also functions to discourage outside investors from buying larger stakes in the company, considering the limited legal power that can be obtained.[143] It has also been argued that regulation fails to facilitate the ability of shareholders to effectively coordinate decision making, giving management a relative advantage with respect to entrenching its control over corporate strategy.[144]

By way of comparison, boards in a number of EU member states require, for example, the consent of shareholders to issue new shares (sometimes a simple majority for pre-emptive offerings and a qualified majority for directed offerings) or pay dividends. In a number of EU

[137] *See* Cools (2004), *supra* note 63, at 46-47.
[138] *Id.*; for example, under Delaware law proposals for charter amendments can only be made through a proposal from the board at the shareholders' meeting; DGCL § 242 (b)(1).
[139] *See* Bebchuk (2005), *supra* note 135.
[140] *Id.*
[141] *See* Cools, *supra* note 63, at 64.
[142] *Id.*
[143] As a significant portion of the largest US corporations are domiciled in Delaware, the laws of this jurisdiction are used to represent the prevalent position in the United States.
[144] *See* Bebchuk (2005), *supra* note 135 and Lucian A. Bebchuk & Scott Hirst, *Private Ordering and the Proxy Access Debate*, 65 BUS. LAW. 329 (2010).

member states, shareholders have further powers that can be effectively enforced at shareholders' meetings,[145] where a controlling shareholder can wield considerable influence based on his or her holdings. Where the allocation of legal powers favors shareholders, the founders must ensure they maintain sufficient voting rights in order to maintain control.[146] In some cases, however, legal institutions have developed that further strengthen the position of controlling shareholders. Control enhancing mechanisms can be seen as a complementary institution that can be used to leverage the monitoring function of controlling shareholders. In this way, controlling shareholders can obtain economies of scale and decrease firm specific risk.[147] In this environment, the control rights of minority shareholders may often be limited. Even if corporate law provides legal avenues for minorities to pursue their rights, the legal system may disfavor such initiatives. For example, the lack of the legal concept of class action may result in the risks of shareholder litigation being too high for minority shareholders.

Control over the use of corporate assets is a key element in bargaining and usually prioritized by the entrepreneur (the presumed "agent"). In governance models reflecting dispersed ownership, control over the use of corporate assets is mainly in the hands of the board of directors, whereas in the context of concentrated ownership, the controlling shareholders often have de facto control over the corporation and its business.[148] However, it is not necessarily the case that control is used to extract private benefits of control. Instead, it is possible that control over the use of corporate assets is a key element of bargaining for an entrepreneur pursuing a business enterprise.

It seems, then, that the expectation that monitoring by principals is a key factor for corporate governance may not accurately reflect the dynamic of the relationship between entrepreneurs and investors in relation to bargaining over the terms of corporate finance and corporate governance. In the context of concentrated ownership, corporate governance mechanisms providing "voice" to the minority may be illusionary, at best. Whatever the case may be, it is also suggested that the monitoring underlying the principal-agent relationship in corporate governance is generally less effective than assumed. This suggests that in addition to agency theory other elements are needed for a better understanding of the dynamics of corporate governance.

E. CHANGING THE INITIAL BARGAIN

This section has highlighted the fact that many factors affect bargaining, not least the industrial and historical development of the corporate environment, which sets the broader framework for contracting.[149] Institutional development is path dependent, and as complementary institutions evolve, the cost of deviating from standardized solutions increases.[150] It has been recognized that the corporate governance outcomes prevalent in a particular environment are not necessarily optimal, even if they are the result of bargaining on

---

145 *See* Cools (2004), *supra* note 63 (Belgium and France) and JESPER LAU HANSEN, NORDIC COMPANY LAW – THE REGULATION OF PUBLIC COMPANIES IN DENMARK, FINLAND, NORWAY AND SWEDEN 74-75 (2003).
146 Cools (2004), *supra* note 63, at 64.
147 Ronald J. Gilson & Alan Schwartz, *Constraints on Private Benefits of Control: Ex Ante Control Mechanisms versus Ex Post Transaction Review* 4 (ECGI Law Working Paper 194, 2012), *available at* http://ssrn.com/abstract=2129502.
148 *See* Becht, Bolton & Roell (2002), *supra* note 44.
149 *See* Roe (2000), *supra* note 14 and Roe *(2003), supra* note 51.
150 *See* Bebchuk & Roe (1999), *supra* note 52.

market terms. Incumbent governance structures do not necessarily exist because they are efficient; rather they can also be the resultof strategic behavior and maneuvering by parties seeking to maximize their own interests.[151] Empirical research also supports the position that the structure of ownership tends to persist over time.[152] Nevertheless, as the relevant parties' investments are specialized and mutually dependent, there will be interest in renegotiating the terms of bargaining on an on-going basis.

As contractual arrangements are necessarily incomplete, there is a need to organize mechanisms for bargaining on an ex-post basis. The participants in an enterprise are aware of the possibility of ex-post bargaining and are therefore unwilling to make initial investments unless they are satisfied that the initial agreement will be respected and that they will not be disenfranchised. Sufficient guarantees against ex-post changes will therefore be a central element of the bargain. This, in turn, emphasizes the importance of corporate governance. In the bargaining approach to corporate governance, the structure of corporate finance can be seen as the main tool for changing the terms of corporate control. As discussed, the balance between the use of equity and debt instruments in corporate finance, and how they are bundled, will determine how control is allocated on the basis of corporate performance. A case in point is including convertible instruments in the bargain, whereby the parties can set triggering events for changing control.[153]

However, there may well be pressure to change the original terms of the bargain. For example, when initial investments are made in specialized assets, resulting in sunk costs, the relative bargaining position of the constituencies may change. Even if the various corporate constituents have committed to certain corporate governance rules, they may well seek to renegotiate these rules as their relative bargaining power increases. In this respect contracts can merely be seen as "frozen" bargaining power.[154] Investors may hesitate to make initial investments if they face a risk of ex-post changes, and may require guarantees to protect their investment. However, they will also compare these risks with other investment alternatives (including making no investment at all), which are all likely to include similar risks in an environment of incomplete contracts.

New legal regulation can also be seen as a mechanism for changing the original corporate governance framework. Corporate constituencies are also interest groups that can use political avenues to pursue corporate interests, and changes in regulation can be seen to reflect changes in the relative bargaining power of these constituencies. The relationship between entrepreneurs and investors will be renegotiated, in part, through political and regulatory intervention as the political bargaining power of these constituencies evolves. Corporate governance regulation can be expected to reflect the interests of politically dominant constituencies. However, different constituencies have different requisites for pursuing their interests in this regard.[155] Theories on political coordination suggest that small interest groups with similar interests overcome coordination problems to sufficiently promote their interests. Small groups of large shareholders in an environment of concentrated ownership have often

[151] Utset (1994-1995), *supra* note 12, at 609.
[152] *See* Jeremy Grant & Thomas Kirchmaier, *Who Governs? Corporate Ownership and Control Structures in Europe* (SSRN Working Paper, June 7, 2004), *available at* http://ssrn.com/abstract=555877.
[153] *See* Gilson (2006), *supra* note 35, at 1677-1678.
[154] Peter Nobel, *Stakeholders and the Legal Theory of the Corporation*, in PERSPECTIVES IN COMPANY LAW AND FINANCIAL REGULATION 176 (Michael Tison, Hans De Wulf, Christoph Van der Elst & Reinhard Steennot, Eds., 2009) .
[155] See MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION (1971).

been identified as such a constituency. On the other hand, the interests of large interest groups with similar interests are generally reflected through the political system. It has been argued, for example, that labor interests are pursued through political avenues. However, large interest groups with dissimilar interests may be more vulnerable than others, as they may face disproportionate coordination costs. Minority shareholders, for example, may have insufficiently similar agendas and overly small financial interests to allow for efficient coordination. The interests of these constituencies, then, may require special attention.

Changes in bargaining power may reflect changes in the overall political economy. As industrial structures develop and the political economy evolves, the initial outcome of bargaining may become sub-optimal. In other words, the original allocation of control is no longer value maximizing from a property rights perspective. At the same time, the relative bargaining power of the corporate constituents may change, leading, a consequence, to changes in the framework for feasible corporate governance outcomes. Technological change can affect the relative importance of different types of firm-specific investments in this regard. For instance, much attention has been paid to the increase in the relative importance of human capital. Here, the outcome of a dispute between the new owners and the manager and former owner of the advertising agency Saatchi & Saatchi has often been cited as a case in point.[156] When the new owners rejected the salary demands of the former chairman, he and several others left the company to set up a competing enterprise – taking with them a significant portion of the company's assets in the form of the human capital.

It has been argued that change is the central characteristic of interaction between economic, political and corporate environments.[157] Technological change affects the business and organizational environments of corporations, and it is vital that the organizational structures of businesses can be adapted to such changing circumstances. Corporate acquisitions and the transfer of control are important elements in this respect. The transfer of control can be seen as a process whereby access to corporate assets is transferred to a party that, due to technological or other changes, can use them more efficiently and give them a higher value.[158] It is therefore important that the transfer of control is appropriately facilitated. However, as discussed earlier, the entrenchment of control is a central characteristic of corporate governance. Creating incentives for changing the structure of corporate ownership may consequently be as important as trying to regulate concerns related to currently dominant structures of corporate ownership.[159] Moreover, many of the governance mechanisms based on monitoring by external parties are less effective than assumed. Consequently, the continued development of different approaches to corporate governance regulation remains important.

F. IMPLICATIONS FOR REGULATION

On a general level, parties should enjoy freedom of contract with respect to different corporate governance solutions, and the promotion of specific structures of governance or ownership through regulation is generally unwarranted. However, it is also the case that the outcomes of bargaining are not necessarily optimal or efficient – especially in the longer term

---

[156] See Raghuram G. Rajan & Luigi Zingales, *The Governance of the New Enterprise* in CORPORATE GOVERNANCE, THEORETICAL & EMPIRICAL PERSPECTIVES (Xavier Vives, ed., 2000).
[157] Ronald J. Gilson, *The Political Ecology of Takeovers: Thoughts on Harmonization of the European Corporate Governance Environment*, 61 FORDHAM L. REV. 161, 175 (1992).
[158] *Id.* at 164.
[159] *Id.* at 174-175.

as the political economy evolves. Moreover, in many cases bargaining is carried out in "an institutional, legal, standardized framework"[160] that shapes the outcomes of that bargaining, and resulting in structures that may or may not be optimal for the enterprise in question. Political factors also have a considerable impact in this respect. The ex-post bargaining process is therefore very important. Moreover, it has been emphasized that as the corporate environment evolves, organizations must have the ability to adapt, in which context the transfer of control is a key element. However, due to the characteristics of corporate governance and the deficiencies in many corporate governance mechanisms, corporate control may be entrenched so that control is not necessarily transferred when it would be expedient to do so. Consequently, new regulatory concepts and mechanisms warrant continued consideration. The next section will turn to a consideration of the regulatory implications of an environment of concentrated ownership.

V. REGULATORY IMPLICATIONS FOR CONCENTRATED OWNERSHIP

A. INTRODUCTION

This study approaches corporate governance from the perspective of financial contracting in order to provide a better understanding of the assumptions upon which corporate governance regulation is based. This approach may capture the dynamic of corporate governance, especially in the context of concentrated ownership, where a controlling shareholder can be seen as an entrepreneur negotiating the terms of corporate finance with other constituencies, including other shareholders. The study argues that a corporation's corporate finance and corporate governance structures are the outcome of bargaining, and that parties should be allowed freedom of contract in this regard. For example, it could be argued that introducing the concept of one-share-one-vote would be an inappropriate limitation of the potential outcomes of bargaining and freedom of contract.[161] However, adopting this approach does not mean that regulatory intervention is unwarranted as such. It is clear that different corporate governance structures are vulnerable to abuse, and there is no guarantee that different corporate constituencies are not primarily driven by self-interested action at the cost of others. The study also recognizes that control is often entrenched and that regulatory intervention may be justified to prevent abuse and to facilitate transfer of control where incumbent control has become suboptimal. However, the question remains as to how these issues could be approached through regulation.

The bargaining theory of corporate governance suggests that for an entrepreneur the value of control is based on the ability to direct corporate strategy and the use of corporate assets to maximize value to the benefit of all shareholders. The value of control is in the possibility it offers an entrepreneur to pursue a chosen strategy even in case of disagreement with external investors. This is something that external investors have agreed to when deciding to make the investment, and the entrepreneur may have had to pay for this option through the terms of financing acceptable to them. However, the (potential) superior performance achieved through the entrepreneur's control of the corporation is expected to benefit all shareholders alike.

This premise has certain implications for corporate governance regulation. It means that there should be no need (or justification) for controlling shareholders to divert corporate

[160] *See* Deffains & Demougin (2006) *supra* note 104.
[161] Nobel (2009), *supra* note 154, at 177.

opportunities (i.e., "steal") from the corporation. Consequently, the controlling shareholder should be able to agree to corporate governance regulation that protects the cash-flow rights of investors, as long as the ability of the entrepreneur to decide on strategy and day-to-day management remains unchallenged. The possibility granted to the entrepreneur of affecting corporate strategy is also based on the promise of superior performance over time. The controlling shareholder should thus be encouraged to agree to change the balance of governance rights if such performance is not ultimately delivered. In connection with bargaining over the terms of financing, controlling shareholders should be encouraged to transfer governance rights if performance has been unsatisfactory. A controlling shareholder can be incentivized to transfer control independently if the shareholder can no longer provide superior performance.

This section will discuss the basis for regulatory intervention in the context of concentrated ownership based on the bargaining perspective of corporate governance.

B. REGULATORY CHALLENGES OF CONCENTRATED OWNERSHIP

Concentrated ownership has been associated with low levels of investor protection and the risk of private benefits of control being extracted in the absence of sufficiently effective monitoring mechanisms.[162] Nevertheless, concentrated ownership has also been seen as an effective mechanism for monitoring management. Large shareholders may be better disposed to monitor management than the market-based mechanisms available in a dispersed ownership environment.[163] However, at the same time the risk of the expropriation of corporate assets by the controlling shareholder at the cost of other shareholders emerges.

Nevertheless, concentrated ownership can be a competitive outcome of bargaining over the terms of corporate finance. It has been suggested that investments in a company with concentrated ownership are based on a trade-off between the costs associated with the possible extraction of private benefits of control by the controlling shareholder and the benefit derived from the monitoring function performed by an undiversified and consequently incentivized shareholder. Controlling shareholders are generally not afflicted by the free-rider problem affecting diversified shareholders; i.e. that it would not be in the interests of a specific shareholder to perform monitoring and incurring the full costs of this while all shareholders would share the benefit. Based on the trade-off between the possible extraction of private benefits and the more effective monitoring function of a controlling shareholder, there may well be situations where concentrated ownership, as such, is an efficient ownership structure from the outset.[164] Indeed, even allowing some private benefits of control to be extracted by a controlling shareholder as compensation for an undiversified position and for performing the monitoring function may well be in the interests of other shareholders.[165]

In many cases it is argued that even if diversionary private benefits (i.e., "stealing") could be restricted by appropriate regulation, it would be far more difficult to address distortionary private benefits (i.e., "shirking") in an environment of concentrated ownership. In effect, a large controlling shareholder may, rationally, use corporate control to steer the use of corporate assets for purposes other than maximizing shareholder value. It is argued that in the

[162] See La Porta et al. (1999) *supra* note 19.
[163] Gilson & Gordon (2003), *supra* note 45, at 786.
[164] *See* Gilson (2006), *supra* note 35.
[165] Lucian A. Bebchuk, *A Rent-Protection Theory of Corporate Ownership and Control* (National Bureau of Economic Research, Working Paper 7203, 1999); and Gilson & Gordon (2003) *supra* note 45, at 786.

presence of control enhancing mechanisms this risk is accentuated, as the relative economic risk of the controlling shareholder decreases in relation to his or her level of control.

Another problem with concentrated ownership (and with control enhancing mechanisms in particular) is that changing the structure of ownership, even where such change could be value-increasing, may be difficult.[166] Ownership structures should vary and evolve according to market requirements in order to allow the adoption of the most efficient structure for the prevailing circumstances at a given time.[167] It should be possible to reorganize corporate assets (either inside or outside the firm) as flexibly as possible to respond to market changes. Due to controlling shareholders' ability to extract private benefits of control, it may against their interest to relinquish control unless future potential private benefits are compensated for, which creates a disincentive for controlling shareholders to agree to some value-increasing takeovers.[168] These problems are further accentuated when control enhancing mechanisms are used to separate cash flow and voting rights. Typically, these mechanisms allow controlling shareholders to exert disproportionate control in relation to their capital input. In such situations, controlling shareholders may in fact be incentivized to pursue courses of action that are detrimental to other shareholders.[169]

C. Developing Regulatory Strategies for Concentrated Ownership

Legal strategies should be adapted to the broader institutional environment, including, for example, the prevalent structure of corporate ownership and the quality of enforcement mechanisms. For instance, certain legal strategies that are successfully used in dispersed ownership systems can be ineffective in an environment of concentrated ownership. Disclosure-based corporate governance mechanisms, such as comply-or-explain based regulation, may be of little effect in corporations with a controlling shareholder, for example. In connection with bargaining over corporate governance, these issues should be taken into account in the choice of corporate governance mechanisms.

It is also important to recognize that corporate governance regulation is not an externality imposed to objectively regulate the relationships between corporate constituencies; rather, it should be viewed in the context of bargaining, as a part of the institutional landscape that parties may well seek to use to their advantage. Parties to the bargain should also recognize possible differences in their priorities to allow, where possible, more latitude for the entrepreneur with respect to control over the use of corporate assets, while applying other mechanisms with respect to protecting cash-flow rights, for example.

With respect to corporate governance regulation, legal strategies have been divided into regulatory strategies and governance strategies, where regulatory strategies provide the prescriptive terms for regulating the relationship between corporate constituencies, and governance strategies provide mechanisms for principals to monitor and control the behavior of agents.[170] Regulatory strategies include rules and standards, as well as setting the terms of entry and exit for principals,[171] such as disclosure obligations and appraisal rights, respectively. Governance strategies include appointment rights, decision rights and agent

[166] *See* Bebchuk (1994), *supra* note 60.
[167] Gilson (2006), *supra* note 35 at 1645.
[168] *See* Bebchuk (1994), *supra* note 60.
[169] *See* Bebchuk, Kraakman & Triantis (1999), *supra* note 34.
[170] Armour, Hansmann & Kraakman in Kraakman et al. (2009), *supra* note 32, at 39.
[171] *Id.*, referred to as "Affiliation Terms."

incentives. It has been noted that governance strategies typically require principals to be active and coordinate their actions; thus, for example, such strategies may be inadequate for minority shareholders faced with free-rider problems. Regulatory strategies imposing rules and standards may be more effective for setting limits on the activities of controlling shareholders, provided appropriate enforcement institutions are available.

It is also important to consider the type of minority protection mechanisms that should be available. As earlier discussed, it may be difficult for the minority to challenge the control of a large shareholder. Minority shareholders can be prevented from acting by collective action problems, for example, and as a result governance strategies requiring active monitoring by shareholders may be ineffective in this environment. Controlling shareholders are likely to be opposed to regulation that challenges their ability to decide on corporate strategy or significantly changes governance rights. Considerable efforts may be made to ensure that this control cannot be challenged. Governance strategies, consequently, are likely to be unsuccessful in this environment.

On the other hand, a system where minority shareholders are able to challenge the controlling shareholder and veto day-to-day management decisions is vulnerable to opportunistic behavior by the minority.[172] Potential regulatory strategies for protecting minority shareholders should not seek to challenge the ability of the controlling shareholder to decide on corporate strategy; rather, they should focus on protecting the minority's cash-flow rights. In these circumstances, it may be appropriate to base the relevant mechanisms, for example, on certain rules and standards, as well as on exit rights at fair value, rather than on governance rights.

With respect to standards, for instance, stricter rules on related-party transactions should be acceptable to the controlling shareholder. An "entire fairness" standard could also be introduced with respect to related-party transactions. Fiduciary duties towards other shareholders could well be introduced for situations where a controlling shareholder chooses to enter into transactions with the controlled company, for example.

Some governance strategies might also be suitable for regulating the relationship between controlling shareholders and minority shareholders. For instance, it should be possible to agree on the minority shareholders' right to nominate independent directors , as long as they constitute a minority of the board, for this would not challenge the control of the controlling shareholder. What it might do, however, is introduce an increased degree of legitimacy and protection for independent board members.

Governance rights also include different incentive structures. Regulation might seek to incentivize controlling shareholders to transfer control when a change of ownership structure is called for. For example, it may be possible to induce controlling shareholders to independently transfer control when the controlling shareholder can no longer contribute to the corporate enterprise and the structure of ownership has become sub-optimal. It has been noted that in jurisdictions with a prevalence of concentrated ownership, it may be reasonably cost-efficient to maintain a controlling position based on a favorable institutional environment. For example, a relatively low level of ownership may provide high levels of governance rights (through control enhancing mechanisms or the impotence of governance rights afforded to minority shareholders). It has also been noted that tax regulation may favor

172 Goshen & Hamdani (2013), *supra* note 11, at 610.

pyramid structures or the maintenance of control positions. Changing this environment could increase the costs of maintaining controlling positions and induce control transfers. Tax rules that are less favorable for maintaining control structures can also provide incentives to incumbent owners to transfer control when they can no longer provide entrepreneurial input. This type of regulation is likely to be more effective and even more politically feasible than initiatives that seek to challenge control against the will of the entrepreneur.

In this context, incentive structures should be understood in broader terms. Merely seeking to align the interests of controlling shareholders (the "agent") with those of the minority (the "principals") seems to ignore certain key aspects of the relationship between these constituencies. However, in bargaining over the terms of corporate finance, penalties or disincentives might also be introduced if control is maintained under certain circumstances. As earlier discussed, tax rules may be considered in this regard. Furthermore, convertible financial instruments could also be used to facilitate change of control where there has been a failure of performance.

D. REGULATING CONTROLLING SHAREHOLDERS AND CHANGE OF CONTROL IN THE EU

The potential for conflicts of interest among corporate constituencies is underlined in connection with change of control transactions. Regulation on takeovers, for example, has been the subject of much controversy in the EU. The directive on takeovers (the "Takeover Directive")[173] was adopted in 2004, after a politically divisive legislative process lasting almost two decades.[174] The directive introduced certain mechanisms aimed at challenging controlling shareholders. The so called break-through rule was intended to provide a framework applied in connection with takeover situations for bypassing mechanisms preventing the execution of a bid (such as super-voting shares or transfer restrictions).[175] Ultimately, the implementation of the break-through rule was optional, and as a result very few countries introduced the rule on a mandatory basis. Nevertheless, the rule and the related debate provide a rich context for better understanding how the interests of key corporate constituencies are reflected in corporate governance regulation. The Takeover Directive can therefore serve as a useful framework for studying the dynamics of bargaining over corporate control.

It has been observed that had the break-through rule been imposed, shareholders would hardly have been remained passive; instead, they would certainly have taken steps to protect their control positions.[176] New companies listing on the stock market could also have adopted control structures not covered by the rules. A regulatory solution that could have similar effects as a break-through rule in the context of concentrated ownership and controlling shareholders would consist of more intrusive rules on self-dealing, rules that raised the cost of maintaining controlling stakes in unprofitable enterprises and rules that decreased the threshold for transferring control. It has been noted that in many EU member states maintaining control is relatively cheap due to the use of control enhancing mechanisms and

---

[173] Directive 25/2004/EC of the European Parliament and of the Council of 21 April 2004 on Takeover Bids, 2004 O.J. (L142) [hereinafter the Takeover Directive].
[174] *See Report of the High Level Working Group of Company Law Experts on Issues Related to Takeover Bids*, Brussels, January 10, 2002, available at http://ec.europa.eu/internal_market/company/docs/takeoverbids/2002-01-hlg-repprt_en.pdf.
[175] Takeover Directive, art. 11, para. 4.
[176] John C. Coates IV, *Ownership, Takeovers and EU Law: How Contestable Should EU Corporations Be?* 12 (ECGI Law Working Paper 11/2003), available at http://ssrn.com/abstract=424720.

favorable tax regimes.[177] Minimum dividend rules can also protect the cash-flow rights of minority shareholders. These types of provisions would have been better adapted to governance systems based on concentrated ownership and may have also been less politically controversial.

The Takeover Directive also introduced a mandatory bid rule providing shareholders with an exit right at a fair value in cases of transfer or accumulation of control. According to the directive, a shareholder must launch a tender offer for all equity instruments upon acquiring "control" of the company. The relevant thresholds are subject to national laws and are generally set at the level of a thirty percent holding in the target company. The mandatory bid rule has been seen to prevent transactions that would extract value at the cost of other shareholders rather than from increased efficiency or synergies. Through the fair or equitable price requirement, the rule also limits control premiums payable to controlling shareholders. However, the mandatory bid rule can have negative effects in a context of concentrated ownership, as it increases the price of takeovers and thus reduces trade in control positions. Based on the arguments put forward in this study, the EU should focus on limiting the private benefits of control available from operating a corporation rather than on introducing regulation that can entrench concentrated ownership and increase the threshold for changing control.

VI. CONCLUSIONS

This study has focused on corporate governance in the context of concentrated ownership, arguing that concentrated ownership does not necessarily correlate with inferior economic performance or with the extraction of private benefits of control; rather, it can provide the basis for a competitive model of corporate governance. In light of the above, certain theories regarding corporate governance may be inadequate for explaining and defining the relationships between corporate constituencies in different situations. In particular, this study argues that corporate governance regulation may sometimes be based on assumptions that are flawed in certain corporate environments.

In the context of concentrated ownership, in particular, corporate governance and corporate finance outcomes can be defined in terms of financial contracting, where the relationship between the controlling shareholder (entrepreneur) and external financiers, including minority shareholders, (investors) is characterized by on-going bargaining over corporate control. The potential conflicts of interest arising in this relationship can be acknowledged, and it is unnecessary to focus solely on aligning the interests of the controlling shareholder (the "agent") with those of the minority shareholders ("principals"). The approach recognizes that the relative value given by the parties to cash-flow and control rights may differ, allowing for an efficient outcome to be reached as a result of bargaining. For the purposes of corporate governance regulation, this approach also suggests that it is appropriate to limit the ability controlling shareholders to extract private benefits (diversionary private benefits) but that intervening in control rights established on the basis of bargaining may not be equally justified.[178]

[177] *See* Randall Morck, *How to Eliminate Pyramidal Business Groups: The Double taxation of Intercorporate Dividends and Other Incisive Uses of Tax Policy,* in TAX POLICY AND THE ECONOMY, Volume 19 136 (James M. Poterba, ed., 2005).
[178] *See* Goshen & Hamdani (2013), *supra* note 11.

While transfer of control is an important adaptation mechanism for corporations in an evolving business environment, the study recognizes that the characteristics of corporate control and the mechanisms related therewith may actually facilitate entrenchment of control. As discussed earlier, many current corporate governance mechanisms are less effective than assumed – regardless of ownership structure. The conclusion of the study is that regulation may be called for to facilitate transfer of control and that combining incentives and penalties (in the form of different combinations of financial instruments, for example) that do not directly challenge control – but allow the controlling shareholder to take the decision to transfer control independently – may be the approach that best reflects the dynamics of entrepreneurship and corporate control.

For the purposes of EU corporate governance regulation, the above would entail that the use of a variety of financial instruments should be facilitated, and, in particular, that the use of convertible instruments should not be discouraged. In contrast, the entrenchment of control should be discouraged, and the facilitation of the concentration and maintenance of corporate control based on favorable tax treatment should be avoided.[179] With respect to EU takeover regulation, it seems clear that the decision not to make the implementation the so-called break-through rule mandatory was a successful outcome, as it would have provided a direct challenge to incumbent control. Mechanisms that allow the entrepreneur to independently assess the premises for maintaining control would better reflect the interests of the affected constituencies.

More stringent regulation could also be introduced with respect to related-party transactions. It should be noted that the EU Commission is contemplating such regulation and originally proposed a mechanism that would make material related-party transactions subject to approval by shareholders (excluding any shareholder who is party to the transaction).[180] Nevertheless, while the need to monitor related-party transactions is a valid concern, such mechanism would be ill-suited to concentrated ownership, as it challenges the control rights of controlling shareholders and would allow opportunistic behavior by the minority. An alternative mechanism would involve increasing disclosure requirements (as has also been proposed by the Commission) and, for example, the introduction of fiduciary obligations for controlling shareholders in connection with related-party transactions, thus further regulating the terms on which the transactions are entered into.

[179] *See* Morck (2005), *supra* note 177.

[180] *Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC As Regards the Encouragement of Long-term Shareholder Engagement and Directive 2013/34/EU as regards Certain Elements of the Corporate Governance Statement,* COM(2014) 213 final, 2014.

CHAPTER 3

A POLITICAL NARRATIVE OF NORDIC CORPORATE GOVERNANCE: SHAREHOLDERS, STAKEHOLDERS AND CHANGE OF CONTROL

Corporate governance in the Nordic countries has been the subject of increasing interest in the international corporate governance debate. Concentrated ownership combined with reportedly low private benefits of control have been seen as a competitive model of governance. The low levels of private benefits of control in the Nordics are claimed to result from the non-pecuniary nature of control benefits and the social norms characteristic to the Nordic environment. However, the effects of the political environment on the corporate governance framework should not be underestimated. This study argues that the limitation of private benefits of control in the Nordics has mainly been due to an export-driven industrial structure open to product market competition, while economic crises and the development of pension systems have decreased resistance to better investor protection. This chapter sets out a political narrative of Nordic corporate governance and considers the resulting regulatory implications. The study argues that Nordic governance models are not without their own challenges and that the evolution of the EU as a parallel political framework has provided a welcome avenue for regulatory change that can circumvent entrenchment in national corporate regulation. The chapter concludes with an assessment of appropriate EU level regulatory strategies for the regulation of corporate governance.

I BACKGROUND TO THE NORDIC MODEL

The governance models adopted in the Nordic countries have attracted increasing international interest.[1] Following the financial crisis there have been concerns related to the perceived "short-termism" of institutional shareholders and the status of shareholders more generally in corporate governance. It has been argued that models of corporate governance are failing due to inadequate monitoring by dispersed shareholders.[2] As a result, there has been an emerging interest in the role of large shareholders in developing better corporate governance solutions for publicly traded corporations.[3] Corporate governance models in the Nordic countries, where corporate ownership remains somewhat concentrated but where private benefits of control are reported to be relatively low, have therefore been of some interest in the international corporate governance debate.

---

[1] Richard Milne, Model Management, *Financial Times*, March 21, 2013, at 5.

[2] Lynn Dallas, *Short-Termism, the Financial Crisis and Corporate Governance*, 37 J. CORP. L. 264 (2011).

[3] *Report of the Reflection Group on the Future of EU Company Law* (April 5, 2011), *available at* http://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en.pdf [hereinafter *Reflection Group Report* (2012)], and *EU Commission Green Paper, The EU Corporate Governance Framework* COM(2011) 164 final (April 5, 2011) [hereinafter *Corporate Governance Green Paper*].

The Nordic corporate environment has generally been characterized by the prevalence of concentrated ownership and by the use of control-enhancing mechanisms for leveraging the position of controlling shareholders. While corporate governance models, to a large extent, support the control rights of large shareholders,[4] other stakeholders, such as creditors and employees, have relatively strong protection based on creditor rights and employment legislation.[5] This environment would generally be conducive to low levels of minority shareholder protection; nonetheless empirical research has reported the private benefits of control enjoyed by controlling shareholders to be relatively low. In fact, Nordic corporate governance has at times been seen as an ideal model.[6]

Explanations for the low levels of private benefits reported in the Nordics have been based, among others, on the effect of social norms characteristic to the Nordic environment and the non-pecuniary nature of control benefits (such as the social status associated with corporate ownership).[7] It has also been suggested that strong tax compliance and lower levels of crime in the Nordic countries[8] help explain the behavior of controlling shareholders. Even the role of the press has been mentioned as a factor contributing to better monitoring of controlling shareholders.[9] However, the effects of the political environment on the framework of Nordic corporate governance should not be underestimated.

This study argues that the outcomes of corporate ownership and corporate governance are affected by industrial and political developments. Nordic models of corporate governance remain subject to path dependence and the development of the overall political economy. The chapter will consider the resulting regulatory implications. The study argues, inter alia, that the evolution of the EU as a parallel political framework has in fact provided a welcome avenue for regulatory change that can circumvent entrenchment in national level corporate regulation. The chapter concludes with an assessment of appropriate EU-level regulatory strategies for the regulation of corporate governance.

A. Political Aspects of the Nordic Corporate Environment

Corporate governance is of considerable political interest due to its economic impact and its potential effects on the distribution of wealth among corporate constituencies. Regulation can generally be seen as the outcome of the interaction between political and market structures, reflecting the impact of interested market participants and the political environment.[10] In this

---

[4] Jesper Lau Hansen, Nordic Company Law – The Regulation of Public Companies in Denmark, Finland, Norway and Sweden 75 (2003).

[5] *Id. at* 75-80.

[6] *See* Richard Milne (2013), *supra* note 1; Hansen (2003), *supra* note 4, at 1.

[7] *See* Ronald Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy,* 119 Harvard L.R. 1642 (2006).

[8] *See* John C. Coffee Jr., Do Norms Matter?: A Cross-Country Examination of the Private Benefits of Control (*Columbia Law School Center for Law and Economic Studies Working Paper No. 183*, 2001), *available at* http://papers.ssrn.com/Paper.taf?abstract_id=257613.

[9] *See* Alexander Dyck & Luigi Zingales, *The Corporate Governance Role of the Media, in* The Right to Tell: The Role of Media in Development 107 (Roumeen Islam, ed., 2002).

[10] *See* George J. Stigler, *The Theory of Economic Regulation*, 2 Bell J. of Econ. & Man. Sci. 3 (1971); Sam Peltzman, *Toward a More General Theory of Regulation*, 19 J. of Law and Econ. 211, 212-214 (1976); Roger M. Barker, Corporate Governance, Competition and Political Parties, 19-24 (2010), Mark J. Roe, *Political Preconditions*

respect corporate law and corporate governance regulation can be expected to reflect the interests of dominant corporate constituencies.[11] Changes in regulation can be seen to reflect changes in the relative bargaining power of these constituencies. At the same time, corporate governance is significant for the competitiveness of corporations as vehicles for business enterprise. Regulatory outcomes are the result of political processes and are not necessarily optimal for the purposes of efficiency or economic growth and even have significant negative welfare effects. Even the overall institutional structure itself can be inefficient.[12] Moreover, entrenchment by powerful incumbent constituencies, for example, can easily lead to suboptimal regulatory solutions, even in the face of increasing product market competition. It is therefore important to understand the political aspects of corporate governance and how corporate governance regulation may be affected by changes in the political economy.

Different political coalitions between corporate constituencies result in different ownership structures and corporate governance models. In the Nordic countries, coalitions have traditionally been formed between large shareholders on the one hand and management and labor on the other.[13] For the purposes of political economy this environment can been seen to represent a coalition among constituencies with undiversified risk, i.e. labor interests and the interests of lenders or large shareholders, who may prefer lower risk strategies, as opposed to strategies preferred by dispersed shareholders.[14] In this model, employees can be expected to support large shareholders and leave their corporate decision-making rights unchallenged in return for improvements in job security.[15]

However, over the past decades the political economy has evolved in such a way that labor interests have increasingly shifted towards supporting enhanced minority protection. The development of pension systems towards larger portions of funded pension regimes has been one of the underlying causes of this development.[16] Through the pension system, labor interests are more aligned with better investor protection, and there is, if not direct support, at least less political resistance to the introduction of minority protection mechanisms.[17] The political economy in the Nordic region has also been affected by globalization as an external factor. The globalization of markets and increased international product market competition has particularly affected small export-reliant states, such as the Nordic countries, and restricted the rents available from corporate enterprise.[18] As the importance of equity as an investment form has increased,

---

to Separating Ownership from Corporate Control, 53 STAN. L. REV. 539 (2000); *see also* MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE (2003).

[11] *See* John Armour, Henry Hansmann & Reinier Kraakman, *Agency Problems and Legal Strategies*, in RENIER KRAAKMAN ET. AL, THE ANATOMY OF CORPORATE LAW, A COMPARATIVE AND FUNCTIONAL APPROACH 35 (2009).

[12] DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 107-117 (1990).

[13] PETER A. GOUREVITCH & JAMES SHINN, POLITICAL POWER & CORPORATE CONTROL – THE NEW GLOBAL POLITICS OF CORPORATE GOVERNANCE 140-148 (2005).

[14] Enrico Perotti & Ernst-Ludwig von Thadden*, The Political Economy of Dominant Investors 1* (Tinbergen Institute Discussion Paper TI 2004-091/2, 2004), *available at* http://www.haas.berkeley.edu/groups/finance/June041.pdf.

[15] Gourevitch & Shinn (2005), *supra* note 13, at 65-67.

[16] *Id.* at 145-146.

[17] *See* Timo Korkeamäki, Yrjö Koskinen & Tuomas Takalo, *Phoenix rising: Legal reforms and changes in valuations in Finland during the economic crisis* (Bank of Finland Research Discussion Papers, 2007) *available at* http://www.suomenpankki.fi/en/julkaisut/tutkimukset/keskustelualoitteet/Documents/0701netti.pdf.

[18] *See* Karl-Oskar Lindgren, *The Variety of Capitalism in Sweden and Finland* in THE CHANGING POLITICAL ECONOMIES OF SMALL WEST EUROPEAN COUNTRIES 45 (Uwe Becker, ed., 2011).

controlling shareholders and labor have been forced to accept better minority protection. A marked increase in foreign investment, in particular, has resulted in close scrutiny of Nordic corporate governance models as well as in the introduction of corporate governance models from different types of economies.

The political economy in much of Europe has evolved as a result of the globalization of markets and changes to the industrial environment. In the EU, there has been a general trend over the last two decades towards the introduction of more market-based models of corporate governance, with an emphasis on shareholder primacy coupled with increased investor protection.[19] The EU has also introduced a political dynamic that has provided new avenues for the pursuit of political agendas. EU regulation provides a whole new framework in addition to national regulation with respect to interest group input and the regulatory markets which can circumvent potentially entrenched national regimes.[20] This affects regulatory development at the national level in the Nordic countries.

B. CHANGE OF CONTROL AND TAKEOVER REGULATION IN THE NORDIC CONTEXT

The regulation of takeovers is an interesting proxy for corporate governance regulation. Perceived conflicts of interest among corporate constituencies are accentuated in takeover situations, which may provide opportunities for renegotiating the existing status quo. Premiums and other compensation paid in connection with a change of control can come to benefit corporate constituencies unevenly. Management and employees may resist takeovers to protect their existing benefits, or a controlling shareholder may seek significant premiums for the sale of a controlling stake. Takeovers also go to the heart of corporate governance in being so immediately related to control and change of control in corporations. The issues and concerns raised in the prevailing debate on takeover regulation may say much about the structure of governance and the relative interests and political power of the respective corporate constituencies. Therefore, this chapter will also focus on changes in Nordic takeover regulation.

The dynamics of takeovers are considerably different in an environment of concentrated ownership than in companies with dispersed ownership. In companies with dispersed ownership, takeovers or the possibility thereof provide, in effect, a management monitoring function. In the "market for corporate control," takeovers provide the mechanism by which underperforming management can be changed.[21] In companies with concentrated ownership, takeovers do not have the same governance function, as the incumbent controlling shareholder, in effect, can usually veto any change of control proposals. Instead, an undiversified large shareholder can be expected to monitor management in order to maximize the value of his or her holdings. In this regard concentrated ownership has been seen as an alternative monitoring mechanism to takeovers.[22]

---

[19] *See* Laura Horn, *Corporate Governance in Crisis? The Politics of EU Corporate Governance Regulation*, 18 EUR.L.J. 83 (2012).
[20] *See* Helen Callaghan, *How Multilevel Governance Affects the Clash of Capitalisms* (MPIfG Discussion Paper 08/5), *available at* http://www.mpifg.de/pu/mpifg_dp/dp08-5.pdf.
[21] Paul Davies & Klaus Hopt, *Control Transactions*, in Kraakman et al., *supra* note 11, at 227-228.
[22] *See* Marco Becht, Patrick Bolton & Ailsa Röell, *Corporate Governance and Control* (ECGI Finance Working Paper No 02/2002, updated August 2005), *available at* http://ssrn.com/abstract=343461.

In companies with concentrated ownership, takeovers would generally be subject to negotiations between the bidder and the controlling shareholder. Takeover regulation may be of significant importance, however, in protecting minority shareholders from the possible self-interested behavior of the controlling shareholder. Regulation would address the possibility of controlling shareholders extracting private benefits of control in the form of unwarranted control premiums, or seeking to redeem minority shareholders on unfair terms. Regulation would also need to address the possibility of a controlling shareholder deciding not to transfer control even when no longer performing an effective monitoring function.

At the EU level, takeover regulation has been harmonized to some extent, pursuant to the EU directive on takeovers (the "Takeover Directive"[23]) adopted in 2004 after a legislative process that lasted almost two decades and was the subject of much controversy and political compromise. Subsequently, takeover regulation in the Nordic countries has been largely based on the directive. However, the Takeover Directive allows for further national discretion with respect to many aspects of takeover regulation. For example, member states were allowed an opt-out from the directive requirements on "board neutrality" and the "break-through" of certain perceived obstacles to change of control. As control enhancing mechanisms are a prevalent feature in Nordic corporate governance, no "break-through" rules have been adopted, of course. Moreover, exemptions to mandatory bid obligations are a fairly common feature in the most active Nordic takeover market, Sweden, reflecting the need to accommodate the requirements of concentrated ownership. In addition, the Nordic countries have many other regulations that affect the interests of different corporate constituencies in takeovers, including self-regulation and policies and practices related to exemptions from certain requirements in national takeover rules.

Takeover regulation has been the subject of recent debate in the Nordic countries,[24] and in the EU more generally. It has been argued that in the prevailing institutional environment takeovers may have been based less on synergies or economic efficiency than on creating short term benefits for shareholders at the cost of other constituencies, such as employees or creditors.[25] Moreover, there has been some increase in protectionist tendencies in different EU member states more generally. Cross-border takeovers, in particular, have become more suspect in the eyes of legislators.[26] Regulatory changes in the EU have also been criticized for adopting concepts and regulation that do not take into account differences in economic and institutional structures within the union. For example, it has been argued that corporate governance models adopted from the United States or the United Kingdom may be incompatible with, and hence inefficient in, a Continental European or Nordic context.[27] However, it is interesting to consider how these developments reflect a political approach to corporate governance. In terms of political economy, some developments could be deemed to represent a shift back towards a more corporatist political and economic model.[28] Furthermore, some of the abovementioned concerns may well have been self-serving, a

[23] Directive 25/2004/EC of the European Parliament and of the Council of 21 April 2004 on Takeover Bids, 2004 O.J. (L142) [hereinafter Takeover Directive].
[24] *See* BEATE SJÅFJELL, TOWARDS A SUSTAINABLE EUROPEAN COMPANY LAW (2009).
[25] *See* SOPHIE NACHEMSON-EKWALL, AN INSTITUTIONAL ANALYSIS OF CROSS-BORDER HOSTILE TAKEOVERS (2012).
[26] *See* Damien M. B. Gerard, *Protectionist Threats Against Cross-Border Mergers: Unexplored Avenues to Strengthen the Effectiveness of Article 21 ECMR*, 45 COMMON MARKET L.R. 987 (2008).
[27] ANDREW JOHNSTON, EC REGULATION OF CORPORATE GOVERNANCE 268 (2009).
[28] Gourevitch & Shinn (2005), *note* 13, at 60.

result of politically dominant constituencies seeking to prevent changes to existing regulatory regimes.

D. OBJECTIVES OF THE STUDY

This chapter is concerned with the regulatory implications of a political economy approach to Nordic corporate governance and takeover regulation. Different corporate constituencies have different interests with respect to takeovers which is reflected in the political dynamic of takeover and corporate governance regulation. The chapter will investigate whether recent changes in takeover regulation reflect changes in the relevant political economy, and whether possible differences between national regulations in the Nordic region can be explained by differences in their political economy. Findings in this regard can confirm or disprove the hypothesis of the study, i.e., that corporate governance models in the Nordics reflect industrial and political developments and the evolution of the overall political economy. Building on these findings, the chapter then considers how corporate governance and takeover regulation can be developed and what regulatory strategies might be available in this environment. The study seeks to contribute to a better understanding of the relationship between corporate governance and takeover regulation and the political economy from a Nordic perspective.

The chapter is structured as follows. In section two, the study describes the corporate environment in the Nordic countries in broad terms. The study focuses on the structure of corporate ownership and, in particular, the political environment as it relates to corporate ownership. In section three, the study turns to the discussion of the political approach to corporate governance, examining theories related to the political economy of corporate governance and explanations on the relationship between different corporate governance solutions and political coalitions between different corporate constituencies. The section discusses formal corporate governance arrangements in the Nordic countries and then looks at how corporate governance solutions in the Nordic countries reflect political explanations of corporate governance. In section four, the study turns to change of control transactions in the Nordic region. The section discusses the dynamic of takeovers and takeover regulation in the context of concentrated ownership with an emphasis on how the function of takeovers in this environment differs from that in dispersed ownership situations. The study then considers takeovers and takeover regulation in the Nordic countries from the perspective of the political approach to corporate governance. The section concludes by comparing regulatory development in Finland and Sweden in the light of differences in their respective political economies. Section five considers the relationship between corporate governance and takeover regulation on the one hand and the changing political economy on the other from the perspective of how regulatory changes come about. Based on theories of the political coordination of interest groups,[29] the study seeks to identify how the interests of different corporate constituencies are likely to develop and which constituencies may, in fact, be in need of any further regulatory intervention. Section six considers the recent corporate governance debate in the Nordics in light of the arguments made in the study, and concludes by considering appropriate regulatory strategies for this environment.

Sweden, in particular, has received much attention as the largest market of Nordic region, with established corporate governance practices and an active takeover market. Sweden has therefore

[29] *See* MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION (2nd ed., 1971).

often been seen as representative of the whole Nordic region in studies related to corporate governance. This chapter will also focus mainly on Sweden, but Finland too will be discussed, as the two countries have similar industrial structures. Norwegian and Danish corporate governance matters will also be considered to a limited extent.

II. CORPORATE OWNERSHIP AND CONTROL IN NORDIC COUNTRIES

Corporate governance and the structure of corporate ownership are closely related and rest on the development of economic, political, legal and historical conditions.[30] The importance of historical development and path dependence has been emphasized in the legal literature on corporate governance.[31] Taken as a whole, the political aspects of corporate governance should not be underestimated. Corporate constituencies make use of regulation and the political framework to further their corporate interests in relation to corporate governance. As these constituencies may have significant political influence, corporate governance can easily become the target of considerable political interest.

Below, this section briefly describes the key characteristics of corporate ownership and control in the Nordic countries, as well as some of the explanations regarding the historical and political background for the prevalent structures of corporate ownership.

A. STRUCTURE OF CORPORATE OWNERSHIP AND CONTROL

Nordic corporate governance has traditionally been characterized by relatively high levels of concentrated ownership and the application of different types of control mechanisms.[32] Nevertheless, empirical studies report low levels of private benefits of control in these countries.[33] As concentrated ownership and control mechanisms, in particular, have often been linked to the extraction of private benefits, the Nordic model of corporate ownership and corporate governance has been the focus of quite some interest as a model for an efficient structure of corporate control. Some scholars have argued that controlling shareholders extract non-pecuniary private benefits in the form of the political influence and status that go with considerable corporate power.[34] Such benefits are claimed to be specific to the controlling shareholder and not extracted at the cost of other shareholders. Other scholars, however, have found satisfactory explanations in the path dependent nature of corporate governance and the corporate legal environment that may have resulted over time in relative advantages for concentrated ownership over a dispersed ownership model.[35]

---

[30] Peter Högfeldt, *The History and Politics of Corporate Ownership in Sweden*, in A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS 517, 518-522 (Randall K. Morck ed., 2005).
[31] *See* Lucian A. Bebchuk and Mark J. Roe, *A Theory of Path Dependence in Corporate Governance and Ownership*, 52 STAN. L. REV. 127 (1999).
[32] *See* Johan E. Eklund, *Corporate Governance and Investments in Scandinavia – Ownership Concentration and Dual-class Equity Structure* (CESIS Electronic Working paper Series, 2007), *available at* http://www.infra.kth.se/cesis/documents/WP98.pdf.
[33] Martin Holmén & Peter Högfeldt, *Pyramidal Discounts: Tunneling or Agency Costs*? (ECGI Working Paper 73, 2005), *available at* http://ssrn.com/abstract=667743.
[34] *See* Gilson (2006), *supra* note 7, at 163-165.
[35] *See* Roe (2000), *supra* note 10; Roe (2003), *supra* note 10.

1. Concentrated Ownership

Ownership concentration in the Nordic countries remains relatively high, with the reported average (mean of a data set of the largest listed companies) ownership share of the largest shareholder at 23.5 percent and for the top five shareholders together 44.8 percent.[36] In Sweden and Finland, single large shareholders are common even in larger listed companies. In Norway it seems that the level of holding of the single largest shareholder is somewhat lower, but it is common for companies with concentrated ownership to be controlled by a few large shareholders..[37]

During the past decades traditional ownership structures have weakened in the Nordic countries – especially in Sweden.[38] The ownership of key families has decreased, as have their spheres of influence; nevertheless, over 60 percent of companies in the Nordics have at least one shareholder with over 20 percent of the votes and over 20 percent have a shareholder with more than 50 percent of the votes.[39] Foreign ownership has increased considerably since the 1980s, and new industries have emerged to challenge the traditional dominance of the raw material and machinery based industries that dominated the economies of Finland and Sweden during the larger part of the 20th century. Nonetheless, Henrekson & Jakobson find that while the position of traditionally dominant shareholder groups in Sweden has decreased over the past decades, this has not resulted in a significant increase in dispersed ownership. The institutional framework is still based on concentrated ownership, if not in a listed context then through the increase of foreign ownership (subsidiaries) or private equity.[40] Moreover, they observe that monitoring by controlling shareholders is still a vital element of corporate governance. The authors argue that to the extent that this ownership structure cannot be maintained in publicly traded companies, these structures will be maintained outside the listed context (i.e., as foreign subsidiaries or companies held by private equity).

There has been some concern that concentrated ownership could negatively impact corporate performance and share value.[41] However, empirical research findings give little support to the assumption that as such concentrated ownership necessarily implies inferior performance. Instead, studies have found a positive correlation between concentrated ownership and firm performance,[42] as undiversified large shareholders or entrepreneurs are able to efficiently monitor

[36] Eklund (2007), *supra* note 32, at 9.
[37] *See* Oyvind Bohren & Bernt Arne Odegaard, *Corporate Governance and Economic Performance in Norwegian Listed Companies* (Norwegian School of Management Working Paper, 2001), *available at http*://finance-old.bi.no/~bernt/governance/Report_Performance.pdf.
[38] *See* Magnus Henrekson & Ulf Jakobsson, *The Swedish Corporate Control Model: Convergence, Persistence or Decline*? (IFN Working Paper No. 857, 2011), *available at* http://ssrn.com/abstract=1734149.
[39] Högfeldt (2005), *supra* note 30, at 518-522, and Ronald Gilson, *The Nordic Model in an International Perspective – the Role of Ownership*, 99-199, in THE NORDIC CORPORATE GOVERNANCE MODEL, 94, 99-100, (Per Lekvall, ed., 2014).
[40] *See* Henrekson & Jakobsson (2011), *supra* note 38.
[41] *See See* Stijn Claessens, Simeon Djankov, Joseph P.H. Fan, & Larry H.P. Lang, *The Benefits and Costs of Group Affiliation*: The Evidence from East Asia (CEPR Discussion paper 3364, 2002) *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=307426.
[42] *See* Torben Pedersen & Steen Thomsen, *Ownership Structure and Value of the Largest European Firms: The Importance of Owner Identity*, 7 J. OF MANAGEMENT AND GOVERNANCE, 27-55 (2003), and Christian Weiss, *The Ownership Concentration of Firms: Three Essays on the Determinants and Effects* 133 (Dissertation, European

management. In fact, the type of shareholders a company has can be a more important factor with respect to corporate performance.[43] In particular, it has been argued that rather than the structure of corporate ownership, it may be the type of controlling shareholder that affects corporate decision making and performance.[44] Having corporations or financial institutions as controlling shareholders is reported to correspond to a higher company value. Family shareholders, on the other hand, may pursue low-risk strategies due to constrained financial resources and an undiversified risk profile, resulting in a lower firm value. La Porta et.al. have identified different types of large shareholders in the Nordic countries, as shown in the table below:

Owner Identity Allocation at 10% cut-off in Nordic Countries[45]

Country	Widely held	Family	State	Widely held Financial	Widely held Corporation	Misc.
Denmark	10%	35%	20%	5%	0%	30%
Finland	15%	10%	35%	25%	0%	15%
Norway	5%	25%	40%	10%	0%	20%
Sweden	0%	55%	10%	30%	0%	5%

2. Control Enhancing Mechanisms

Control mechanisms supporting the control of incumbent shareholders are common in environments with concentrated ownership. Control mechanisms generally function to separate voting rights from cash-flow rights by different means, in order to allow incumbent shareholders to maintain a higher degree of control than their relative share of equity holdings would entitle them to. The control mechanisms used in the Nordic countries include multiple share classes, voting caps and pyramid ownership structures.[46]

According to Eklund, in the Nordic countries the largest shareholder holds an average of more than 20 percent of the capital and close to 30 percent of the voting rights.[47] In Norway, some 14

Business School, International University Schloss Reichanthausen, 2010), *available at* http://hdl.handlenet/10419/30247.

[43] *See* Pedersen & Thomsen (2003), *supra* note 42.

[44] *Id.*

[45] *See* Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Schleifer, *Corporate Ownership Around the World*, 54 J. FIN. 471, 491-93 (1999).

[46] *See* Shearman & Sterling, *Proportionality Between Ownership and Control in EU Listed Companies* (External Study Commissioned by the European Commission, May 18, 2007, Open Call for Tender No MARKT/2006/15/F), *available at* ec.europa.eu/internal_market/company/docs/shareholders/study/final_report_en.pdf [hereinafter EU Proportionality Report].

[47] Eklund (2007), *supra* note 32, at 28.

percent of listed companies are reported to employ a dual-class share structure;[48] in Denmark and Finland the figure is more than 30 percent and in Sweden some 55 percent.[49] In Faccio & Lang (2002), the usage of dual-class share structures was reported for 29 percent of listed companies in Denmark, 44 percent in Finland, 11 percent in Norway and 62 percent in Sweden.[50] The low percentage in Norway has been explained by the fact that government authorization has been required for the introduction of dual-class share structures. As a compensating factor, Faccio & Lang report that 33 percent of listed companies in Norway had pyramid structures, while the corresponding share in the other Nordic countries was significantly lower, as is shown in the table below.[51]

Corporate Control Mechanisms in the Nordics and other European Countries[52]

	Dual-class shares	Pyramid	Cross-holdings
Denmark	0.29	0.17	0.00
Finland	0.44	0.07	0.00
Norway	0.11	0.33	0.02
Sweden	0.62	0.27	0.01
Nordic Average	0.37	0.21	0.01
European Average**	0.24	0.20	0.01

**Nordic countries and Switzerland, Italy, United Kingdom, Ireland, Austria, Germany, France, Belgium, Portugal

To the extent that new companies are introduced on the stock exchange in the Nordic countries, they must generally adhere to the requirements of the markets with regard to corporate governance. It worth noting that the use of dual class share structures has more recently been resisted by investors and it is unusual in new listed companies. However, it is still common for founding owners to maintain controlling stakes in IPOs. It is also possible that other control enhancing mechanisms which are less negatively viewed by external investors are used.

---

[48] Bohren & Odegaard (2001), *supra* note 37, at 21.
[49] *See* Hans Tson Söderström, Erik Berglöf, Bengt Holmström, Peter Högfeldt & Eva M. Meyersson Milgrom, *Corporate Governance and Structural Change, European Challenges* (SNS Economic Policy Group Report, 2003) *available at* http://meyersson.com/ekoradet1-CorpGovEuropean.pdf.
[50] *See* Mara Faccio & Larry H.P. Lang, *The Ultimate Ownership of Western European Corporations,* 65 JFE 365, (2002).
[51] *Id.* at 380-381.
[52] Morten Bennedsen & Kasper Nielsen, *The Principle of Proportionality: Separating the Impact of Dual Class Shares, Pyramids and Cross-Ownership on Firm Value Across Legal Regimes in Western Europe* (Center for Industrial Economics Discussion Papers, University of Copenhagen, 2005), *available at* https://www.wiwi.uni-muenster.de/iw/downloads/Im%20Seminar/ss06/Litss06/T15/16_pp_june.pdf.

There are many concerns related to the use of control enhancing mechanisms. Bebchuk, Kraakman & Triantis have demonstrated how disproportionate voting rights in these types of systems distort the interests of the controlling shareholder.[53] As the relationship between control and capital grows more disproportionate, the economic risks of the controlling shareholder and those of minority shareholders are increasingly unaligned. For example, the controlling shareholder can engage all the company's assets in a venture, while carrying only very limited risk. Empirical research also reports significant private benefits of control in many jurisdictions where control enhancing mechanisms are used.[54]

The structure of corporate ownership bears a relationship to how corporations are controlled. Corporate control is a key factor in any model of corporate governance. In the context of dispersed ownership, control over corporate assets lies mainly in the hands of management and the board of directors, while in companies with concentrated ownership the controlling shareholder is generally able to control the corporation and its business.[55] Legal institutions have developed to complement each of these systems. In this respect, control enhancing mechanisms can be understood as mechanisms for leveraging the monitoring function of controlling shareholders, allowing incumbent shareholders to obtain economies of scale and decrease firm specific risk.[56] Concentrated ownership can provide benefits in the form of effective monitoring of management by largely undiversified shareholders. In an environment that relies on controlling shareholders to perform this function, different means have evolved by which this system of governance can be leveraged. Control enhancing mechanisms allow the entrepreneur or founding shareholder to retain control while raising further equity financing. In this way the control function can be taken advantage of with less capital being tied up.[57] This can provide a competitive form of corporate governance, provided that private benefits of control are sufficiently limited and the controlling shareholder is appropriately incentivized.

B. The Political Environment for Corporate Ownership and Control

The way in which corporations are owned and managed can have a considerable impact on economic development and the interests of different corporate constituencies. The structure of corporate ownership cannot be studied separately from the political environment, as corporate constituencies can pursue their interests through regulatory and political avenues.

The structure of corporate ownership is a result both of specific historical and industrial development and the broader institutional environment. For example, a model of ownership and governance that has developed in an economy with heavy industry which requires considerable capital outlays and untrained labor, could be expected to differ from the model in an economy

---

[53] Lucian A. Bebchuk, Reinier Kraakman & George Triantis, *Stock Pyramids, Cross-Ownership and Dual Class Equity: The Creation and Agency Costs of Separating Control from Cash Flow Rights 12* (*Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series* 249, 1999), *available at* http://lsr.nellco.org/harvard_olin/249.

[54] *See* Tatyana Nenova, *The Value of Corporate Voting Rights and Control: A Cross-country Analysis*, 68 J. FIN. ECON. 325 (2003) and La Porta et. al. (1999), *supra* note 45.

[55] Becht, Bolton & Röell (2002), *supra* note 22, at 46.

[56] Ronald J. Gilson & Alan Schwartz, *Constraints on Private Benefits of Control: Ex Ante Control Mechanisms versus Ex Post Transaction Review* 4 (ECGI Law Working Paper 194, 2012), *available at* http://ssrn.com/abstract=2129502.

[57] *See* Gilson (2006), *supra* note 7.

based on services or products, which require firm-specific investments of skilled labor. Analysis of the political preconditions for corporate ownership suggests, in fact, that there is a relationship between concentrated ownership and politically strong labor institutions. It is argued that in economies with strong labor there is more pressure for corporate governance institutions that favor employees and less for institutions that support shareholder interests.[58] For example, companies are likely to be encouraged to prefer securing employment by expanding at the cost of profitability.[59] In this environment a controlling shareholder would have a better bargaining position over surplus, in relative terms, and would be better equipped to resist the related political pressures.[60]

Other political economy explanations point out that in states with concentrated ownership a political majority with fewer financial incentives (and more labor-oriented financial interests) may oppose a market-based system related to higher risk taking.[61] The outcome of the political system in this environment can be expected to favor large shareholders and labor at the cost of smaller investors and will support complementary governance structures – much of which can be observed in EU member states with concentrated ownership, including the governance structures traditionally associated with the Nordic countries.

1. The Politics of Corporate Ownership and Control

The "Nordic model" of corporate ownership and control has evolved over the 20th century and is largely based on industrial structures that developed during the first decades of the century. The industrial structure in Sweden, for example, was predominantly characterized by large corporations involved in machinery and the refinement of raw materials.[62] Industrial dynasties had a significant role in this development, as a number of families had the means available to develop these types of industries. Ownership was originally concentrated, and controlling shareholders were able to leverage their control positions with different types of control-enhancing mechanisms, including different share classes and cross-ownership. Even if the structure of the economy has changed over the past decades, the basis of the structure of corporate ownership and control originates from the era of industrial corporations, large labor unions and social democratic governments.

In Sweden, Högfeldt has described how labor unions have cooperated with controlling shareholders and supported their corporate power in return for job security.[63] The prevalence of concentrated ownership is based on a political bargain between capital and labor, resulting in a corporatist society with, on the one hand, heavily entrenched, concentrated private ownership and, on the other hand, strong labor unions and strong employee protection. Högfeldt emphasizes the political aspects of these relationships. He argues that a corporate structure with a small number

[58] Mark J. Roe, *The Institutions of Corporate Governance* 18 (Harvard Law School, John M. Olin Center's Program on Corporate Governance Discussion Paper 488, 2004), *available at* http:/www.law.harvard.edu/programs/olin_center/papers/pdf/Roe_488.pdf.
[59] *Id.* at 18-19.
[60] *Id.* at 19.
[61] *See* Perotti & von Thadden, *supra* note 14.
[62] Hans Sjögren, *Welfare Capitalism: The Swedish Economy*, 1850-2005, in CREATING NORDIC CAPITALISM 22, 22-30 (Susanna Fellman, Martin Jes Iversen, Hans Sjögren & Lars Thue eds., 2008).
[63] Högfeldt (2005), *supra* note 30, at 538-549.

of large industrial corporations corresponded with the interests and agendas of the Social Democrats, the dominant party for the majority of the 20th century. Policies supporting the reinvestment of retained earnings to expand industrial companies (thus increasing the political clout of labor) were preferred over policies that would have favored shareholder value. The position of controlling shareholders could be supported (by allowing control enhancing mechanisms, for example) in exchange for strong protection of the established workforce, i.e. the inside-labor, and corporate policies aimed at investment in Sweden.[64]

In terms of concrete measures, Högfeldt argues that the Social Democrats have pursued policies that reinforce entrenchment of incumbent shareholders by "(i) allowing bank ownership of equity; (ii) strong support for control structures that rigidly separate votes from capital, for a long time also combined with rigorous restrictions on foreign ownership of equity, and (iii) persistently giving retained earnings and borrowing a tax advantage over equity." Högfeldt concludes that these policies have hampered the development of companies in growth industries that would have needed outside equity financing and have supported overinvestment in traditional entrenched, capital-heavy, low-growth industries.[65]

The Swedish corporate tax regime has traditionally favored organic growth through favorable treatment of retained earnings and debt financing.[66] Allowing for expedited depreciations of long-term assets also supported this type of activity. Equity investments were disfavored by unattractive dividend taxation.[67] Share buy-backs, another mechanism for returning funds to shareholders, were not possible until the introduction of new company law in 2005.[68] Large shareholders, however, have typically been able to arrange their holdings so as to avoid extensive dividend taxation. For instance, shares could be held through foundations or holding-company structures, to avoid the highest levels of dividend taxation applied to direct dividend payouts.

The pecking order theory of financing suggests that companies and their owners prefer to finance new investments first from retained earnings and second by external debt, with raising new equity being seen as a last resort due, among others, to its dilutive effects. These features seem particularly pronounced in the Nordic model. A characteristic of the Nordic economies is that financing through retained earnings or relationship banking is favored over equity financing, which is typically deemed conducive to structural change.[69] Banks have traditionally enjoyed a strong position in the corporate environment and in corporate governance. The banking sector in Sweden was traditionally an extension of its large industrial families with respect to corporate finance and corporate ownership.

Concentrated ownership and control enhancing mechanisms have been characteristic of Finland as well. However, Finland has differed from Sweden in respect to certain elements of its historical and political development, which has been reflected in the politics of corporate governance. First, per capita GDP in Finland was lower than in the other Nordic countries until

[64] *Id.* at 548.
[65] *Id.* at 560.
[66] See Pierre Habbard, *Corporate Governance in Sweden – An International Trade Union Perspective* (TUAC Report, 2008) *available at* http://www.tuac.org/e-docs/00/00/01/CF/telecharger.phtml?cle_doc_attach=463.
[67] *Id.* at 10.
[68] *Id.* at 11.
[69] Högfeldt (2005), *supra* note 30, at 518.

the late 20th century, and the country has previously experienced more political instability than its Nordic peers.[70] Private ownership has also developed in a somewhat different manner than in Sweden. While Finland has also had important industrial dynasties, their role in the economy has been less significant than in Sweden. In short, private wealth has been limited and there have been fewer private sources of financing available. Until the 1980s large shareholders in Finnish listed companies were typically financial institutions and the government. Pension funds have later seized a larger portion of equity holdings, albeit on a more dispersed basis. This explains, in part, the difference between Sweden and Finland in the levels of concentrated ownership found in empirical studies.

Another factor characterizing corporate governance in Finland is the development of relationships between large shareholders and labor. These relationships have differed from those in Sweden to some extent.[71] The position of labor is said to have been less institutionalized than in Sweden, as labor interests and unions were weakened first by the effects of the Finnish civil war of 1918 and later by internal conflicts within the labor movement.[72] Thus, it is claimed that Finnish labor relations have been dominated, in relative terms, by employer representatives.[73] Nevertheless, maintaining employment was an important factor in Finnish industry, a factor that supported political stability but also led to an increase in organizational rigidity and a lack of readiness for industrial change.[74]

In Finland retained earnings and bank financing have traditionally been preferred to equity or other capital-markets-based financing. Companies were previously incentivized to invest using bank-based debt financing, for example.[75] It was national policy to pursue growth through investment and favor export-oriented industries through low interest rates and currency devaluations.[76] As in Sweden, this has contributed to overinvestment and decreasing returns on investment. In Finland the leading national banks also had established spheres of interest with large shareholdings and a strong voice in corporate governance in large Finnish companies.[77] These positions were largely disposed of in the early 1990s in the aftermath of a deep recession. Moreover, the business environment in Finland was closely regulated, and exports were driven by political factors, such as international trade agreements, that were not necessarily reflective of the interests of the market. Consequently, Finnish corporate strategies may not have been market driven, resulting in some level of inefficiency.

---

[70] Susanna Fellman, *Growth and Investment: Finnish Capitalism*, 1850-2005, 139, 140 in Fellman et al. (2008) *supra* note 62.
[71] *Id.* at 162-164.
[72] *Id.* at 159.
[73] *Id.* at 163-164.
[74] Mika Skippari & Jari Ojala, *Success and Failure of a Conglomerate Firm: The Strategic Paths of Nokia and Tampella in the Liberalizing Finnish Economy after the Second World War*, 238, at 253, *in* Fellman et al. (2008), *supra* note 64.6
[75] *See* Timo Korkeamäki, Elina Rainio & Tuomas Takalo, *Reforming Corporate Law in an Emerging Market: The Case of Finland in the 1970's,* 21 ECONOMICS OF TRANSITION 509 (2013), and Skippari & Ojala (2008), *supra* note 76, at 254.
[76] Fellman (2008), *supra* note 70, at 208.
[77] *See* Ari Hyytinen, Ilkka Kuosa & Tuomas Takalo, *Investor Protection and Financial Development in Finland* in FINANCIAL SYSTEMS AND FIRM PERFORMANCE, THEORETICAL AND EMPIRICAL PERSPECTIVES 86 (Ari Hyytinen & Mika Pajarinen, eds., 2003).

In the course of the 20th century, developments in Denmark and Norway included similar phenomena to those seen in Sweden and Finland, even if many specific national features were also added to the corporate environment.[78] In Denmark, the considerable significance of the agricultural industry and related political agendas have affected corporate structures to some degree. In Norway, geographical factors have influenced both the development of a locally-driven, self-reliant economic structure and, in the latter decades of the 20th century and beyond, a heavy reliance on raw-materials-based industries and related government involvement.[79]

2. Low Private Benefits of Control

In an environment with a prevalence of concentrated ownership and control enhancing mechanisms, the expectation is that significant levels of private benefits of control will be extracted from minority shareholders. Nevertheless, in the Nordic countries this generally is not the case. Empirical studies report levels of private benefit of control which are equal to those in the United Kingdom and the United States and thus diverge from other regions with concentrated ownership. For example, in their empirical studies, Nenova and Dyck & Zingales find varying but nonetheless extremely low values for control-block votes in the Nordic countries.[80] Nenova reports the value of control-block votes in Scandinavian countries at below 10 percent, in line with premiums in Anglo-Saxon countries. In their study, Dyck & Zingales observe block premiums in control block transactions in the Nordic countries with means varying from 1 to 8 percent.

Various types of investor protection indices also award Nordic countries relatively high values. For example, the La Porta et. al. (LLSV) index[81] lists the Nordic countries as having relatively good shareholder protection regulation (anti-director rights) and creditor rights that are, on the whole, slightly below the world average.

	Denmark	**Finland**	**Norway**	**Sweden**	**World average**
Anti-director rights	2.00	3.00	4.00	3.00	3.00
Creditor rights	3.00	1.00	2.00	2.00	2.30
Ownership concentration	0.45	0.37	0.36	0.28	0.46

Source: La Porta et. al (1998)

Several reasons have been suggested for the reportedly low levels of private benefits of control in the Nordic countries. Dyck & Zingales studied the impact of legal origins as well as extra-legal institutions, including product market competition, pressure from public opinion, moral norms,

[78] *See* Martin Jes Iversen & Steen Andersen, *Co-operative Liberalism: Denmark from 1857 to 2007*, 265, in Fellman et al. (2008), *supra* note 62; Lars Thue, *Norway: A Resource-based and Democratic Capitalism,* 394, in Fellman et al. (2008), *supra* note 62.
[79] See Thue (2008), *supra* note 78.
[80] Nenova (2003), *supra* note 54, at 348; *see also* Alexander Dyck & Luigi Zingales, *Private Benefits of Control: An International Comparison*, 59 J. OF FINANCE 537 (2004).
[81] *See* La Porta et al. (1999), supra note 45.

labor monitoring and government control.[82] They conclude that specific institutions, in isolation, are associated with lower levels of private benefits of control.[83] Coffee suggests that social norms, including general compliance with laws, also explain lower private benefits of control.[84] Other authors emphasize the different nature of private benefits of control where controlling shareholders enjoy social or political prestige from corporate ownership. Gilson argues that these non-pecuniary private benefits of control can explain why Sweden, for example, enjoys low levels of economic private benefits of control.[85] Holmén & Knopf also find that extralegal institutions can help explain the low level of control benefits. They argue that "the very prestige (private benefits of control) that is associated with control would be lost if the owners were perceived to be abusing that power."[86]

Another reason given for the traditionally relatively low levels of private benefits of control is the fact that, as smaller export-reliant economies, the Nordic countries have generally been subject to international product market competition. Generally, incumbent industrial and financial interest groups have been found to hold back the development of financial systems in closed economies in an effort to restrain competition. Rajan & Zingales argue that it is in the incumbents' interest to restrict financial development and economic openness to prevent competitors from emerging.[87] Large incumbent industrial groups, for example, will have a competitive advantage in financing their operations from retained earnings, thus blocking new entries to the industry. Moreover, incumbents will actively seek to restrict opening up the economy to new domestic or foreign entrants. Open economies reliant on international trade are, in contrast, likely to face more product market competition and cannot produce the same levels of rent for incumbent constituencies.[88] The economies in Sweden and Finland have traditionally been dependent on export industries and hence subject to international competition. As a result of globalization, increased international product market competition has further affected small, export-reliant states, such as the Nordic countries, restricted available rents and forced controlling shareholders and labor alike to accept better minority protection. The economic crisis of the 1990s also severely affected the previous, predominantly bank-based, financial system and decreased the influence of the banking lobby simultaneous to the emergence of minority shareholder interests resulting from an increase in foreign ownership.[89]

3. The Institutional Environment

Low levels of private benefits of control have also been linked to the broader political environment for corporate ownership. For example, Holmén & Högfeldt have studied pyramid

---

[82] Dyck & Zingales (2004), *supra* note 80, at 575-590.
[83] *Id.* at 590.
[84] *See* John C. Coffee, Jr., *Do Norms Matter?: A Cross-Country Examination of the Private Benefits of Control* (*Columbia Law School Center for Law and Economic Studies Working Paper* 183, 2001) *available at* http://papers.ssrn.com/paper.taf?abstract_id=257613.
[85] Gilson (2006), *supra* note 7, at 1665-1666.
[86] Martin Holmén & John D. Knopf, *Minority Shareholder Protection and the Private Benefits of Control for Swedish Mergers*, 39 J. OF FIN. AND QUANT. ANALYSIS 167, 169 (2004).
[87] *See* Raghuram G. Rajan & Luigi Zingales, *The Great Reversals: The Politics of Financial Development in the Twentieth Century*, 69 J. OF FIN. ECON. 5 (2003).
[88] *Id.*
[89] *See* Korkeamäki et al. (2007), *supra* note 17.

structures in Sweden and found increased agency costs in these types of structures.[90] Nevertheless, they failed to find indications of tunneling or the direct extraction of private benefits. They believe that controlling owners in financially developed countries, such as Sweden, are subject to closer scrutiny, based on well-developed accounting and judicial standards, and that there is less room for direct "stealing" in this type of environment. The authors suggest that the agency costs and discounts related to pyramid structures can be explained by investment behavior (over-investment) based on relatively inexpensive capital obtained from retained earnings as compared to external financing.[91] The cost of financing is driven, among others, by the favorable tax treatment of dividends in pyramid structures.[92]. In Sweden and Finland, dividends paid to legal entities are generally tax-exempt. Large shareholders can structure their holdings so that little tax is paid on dividend payments. In some other jurisdictions, pyramid ownership is efficiently restricted through dividend taxation.[93] The authors conclude that "[t]ax rules that regulate cash flows within the pyramid substitute for weak minority protection and limit incentives for outright stealing."[94]

In other words, controlling shareholders do obtain benefits from holding control blocks rather than diversified positions, but these benefits are based on the institutional environment and the tax system rather than on the direct transfer of wealth through "stealing" from minority shareholders. The explanation for the low levels of private benefits of control is thus, at least in part, political. Through political influence and bargaining, controlling shareholders have secured favorable treatment for concentrated ownership. The Nordic system of corporate governance may well restrict private benefits of control while still supporting control by large shareholders. Nonetheless, the background of the governance system is linked to a political approach to corporate governance.

C. THE ENVIRONMENT FOR TAKEOVERS IN THE NORDIC COUNTRIES

Tender offers have proven controversial in many regions around the world, as they seem to provide a mechanism that effectively circumvents the central governing organs of a corporation, including the board and the operational management. Takeovers as a means to transfer control may provide the potential for emphasizing conflicts of interest among key corporate constituencies. Management and employees may have an interest in retaining the existing corporate status and resisting takeovers, while controlling shareholders may look to extract unwarranted control premiums, for example. Different constituencies are likely to seek to influence regulation in their own interests. In an environment with strong labor interests and concentrated ownership this dynamic can lead to interesting end results. What this study will examine in more detail is the nature of the political environment of takeovers and takeover regulation in the Nordic countries and how it has evolved over the years.

---

[90] Martin Holmén & Peter Högfeldt, *Pyramidal Discounts: Tunneling or Overinvestment*?, 9 *Int'l R. of Finance* 133, 135-136 (2009).
[91] *Id.* at 170.
[92] *Id.* at 136-137.
[93] *See* Randall Morck, *How to Eliminate Pyramidal Business Groups: The Double Taxation of Inter-corporate Dividends and other Incisive Uses of Tax Policy*, 19 TAX POLICY AND THE ECONOMY 135 (2005).
[94] Holmén & Högfeldt (2009), *supra* note 90, at 172.

Despite the prevalence of concentrated ownership, there have been a reasonably large number of takeovers in the Nordic countries,[95] with Sweden being a particularly active market for corporate control. It is interesting that takeovers have occurred with relative frequency in an environment with concentrated ownership and low levels of private benefits of control. Generally speaking, controlling shareholders may indeed be inclined to transfer control if they are only able to extract limited private benefits of control and a new owner (the bidder) can offer a more efficient monitoring function. However, in an environment favoring block-holders, there may be negative consequences for a controlling shareholder selling out.[96] If the institutional environment supports block-holding, the relative benefits of this position may be lost when it is unwound. Moreover, where private benefits have been non-pecuniary, compensation might be hard to realize.[97] The perceived social or political prestige will probably be lost without compensation. In such an environment, creating incentives for changing control may, in fact, be as important as trying to regulate private benefits in the first place.[98]

There has in fact been some concern that the ownership and control structures prevailing in the Nordic countries fail to facilitate change of control when incumbent owners no longer benefit the enterprise.[99] While there is nothing necessarily wrong with concentrated ownership, there is a need to allow new potential owners to challenge the power of the existing controlling shareholders. At the same time, there has been concern that the interests of different stakeholders are not adequately recognized in connection with the takeovers that do occur and that the model of shareholder supremacy that supports blockholder control also allows extraction of private benefits and the transfer of wealth from other constituencies (mainly employees) in connection with control transfers.[100]

D. OWNERSHIP, CONTROL AND THE CHANGING POLITICAL ECONOMY

The structure of corporate ownership and control is heavily entrenched in the institutional environment. Even as industrial structures change and the political economy evolves, many factors that support concentrated ownership and facilitate the concentration of control remain in place.

Some of the elements underlying this environment have been evolving, however. First, with the development of pension systems, for example, the interests of inside-labor have further shifted towards supporting an increase in minority protection. Partially funded pension systems have aligned labor interests with those of shareholders on a general level. For example, in Sweden a comprehensive pension reform was initiated at the beginning of 2000 which increased the holdings of pension funds in Swedish listed companies. This increase has led to a corresponding growth of interest in corporate governance solutions that reflect the interests of minority shareholders. Similar developments have occurred in Finland as well. Finland (like Sweden)

---

95 *See* Marina Martynova & Luc Renneboog, *Mergers and Acquisitions in Europe* (ECGI Finance Working Paper 114, 2006), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=880379.
96 *See* Jeremy Grant & Thomas Kirchmaier: *Who Governs? Corporate Ownership and Control Structures in Europe* (SSRN Working Paper, June 7, 2004), *available at* http://ssrn.com/abstract=555877.
97 Id. at 19.
98 Id. at 20.
99 Söderström et al. (2003), *supra* note 49 at 24.
100 Nachemson-Ekwall (2012), *supra* note 25, at 12 and 245-251.

experienced a severe economic crisis in the early 1990s. Due to the recession and the high level of unemployment, there were no rents available and labor had less entrenched interests in the existing systems – hence there was less resistance to change precipitated by the emergence of minority shareholder interests.[101]

Increases in foreign ownership have also been an important factor in introducing change to the Nordic model of governance.[102] With the increase of foreign ownership, the Nordic model of corporate governance has been subjected to closer scrutiny and comparison with standards in other types of economies. Foreign shareholders have voiced their own expectations with regard to corporate governance based on the institutional environments they know best. A significant part of foreign investment originates from the United States and the United Kingdom,[103] and the corporate governance models in those countries have become benchmarks against which the Nordic model has been compared. However, in many cases incumbent owners have not relinquished control of the corporations where they are shareholders, so foreign ownership may not have affected control-related corporate governance as much as it has affected transparency or the procedural aspects of corporate governance.

A further important development is the evolution of the EU as a parallel political framework. Regulation is the outcome of political processes and can be heavily influenced by politically dominant constituencies. However, the political bargaining power of key corporate constituencies can differ at the national and EU levels. Ferrarini & Miller argue, for example, that national takeover regulation can be expected to be more favorable to management and large shareholders than EU-level regulation. In this respect the EU framework has added complexity to the political dynamic of regulatory development.[104] Moreover, interest groups in smaller member states, such as the Nordic countries, may not always have been able to promote their interests at the level of EU regulation. In fact, EU regulation has been a significant factor driving the development of corporate governance and takeover regulation in the Nordic countries. However, the introduction of EU-level takeover regulation has also raised concerns in the Nordic countries with respect to the interests of large shareholders in particular. Interestingly, in the case of the Takeover Directive, shareholder interest groups in the Nordic countries were successful in preventing the introduction of mechanisms that would have diluted their control positions (while not addressing control enhancing mechanisms used in larger member states, such as France).[105]

As these factors change, there may be increasing tension between traditional structures of ownership and control and the evolving interests of corporate constituencies. Moreover, as a result of changes in the political economy, the relative bargaining power of corporate constituencies may also be shifting, facilitating regulatory change. In the next section, this study

[101] Korkeamäki et al. (2007), *supra* note 17, at 9.
[102] Lindgren (2011), *supra* note 18, at 56-57.
[103] Pekka Ylä-Anttila, Jyrki Ali-Yrkkö & Martti Nyberg, *Foreign Ownership in Finland: Boosting Firm Performance and Changing Corporate Governance* in THE INTERNATIONALIZATION OF ASSET OWNERSHIP IN EUROPE 247, 247-251 (Harry Huizinga & Lars Jonung eds., 2005).
[104] *See* Helen Callaghan, *How Multilevel Governance Affects the Clash of Capitalisms* (MPIfG Discussion Paper 08/5, 2008), *available at* http://www.mpifg.de/pu/mpifg_dp/dp08-5.pdf.
[105] Ulf Bernitz, *Mechanisms of Ownership Control and the Issue of Disproportionate Distribution of Power* in COMPANY LAW AND ECONOMIC PROTECTIONISM: NEW CHALLENGES FOR EUROPEAN INTEGRATION 191, 194-195 (Ulf Bernitz & Wolf-Georg Ringe eds., 2010).

considers the relationship between ownership, control and corporate governance regulation and examines how developments in the political economy can be expected to affect regulation.

III. CORPORATE GOVERNANCE IN THE NORDIC ENVIRONMENT

There is increasing tension between traditional structures of ownership and control and the evolving interests of corporate constituencies as the corporate and broader institutional environments develop. As a result of developments in the political economy, the relative bargaining power of corporate constituencies is also affected, which in turn facilitates regulatory change. In this section, this study considers the relationship between ownership, control and corporate governance regulation in the Nordic context, and how developments in the political economy can affect regulation. I first briefly outline theories on the political aspects of corporate governance[106] and then determine how Nordic corporate governance regulation reflects these theories. One of the key aspects in this regard is the interaction between political and industrial structures and the structure of corporate ownership.

A. CORPORATE GOVERNANCE IN THE POLITICAL ECONOMY

The shareholders, management and employees of a corporation are often identified as the key constituencies in corporate governance. The relationship between shareholders and managers has formed the basis for corporate theories based on agency problems related to the separation of ownership and control. Based, as it is, solely on an analysis of the agency relationship, the focus of corporate governance has been different ways of decreasing agency costs and better aligning the interests of the agents and their principals. These relationships, it has been suggested, are contractual in nature. Nevertheless, it is often recognized that the implicit contracts in the "nexus of contracts" theory are incomplete at best and will need renegotiating from time to time. Different corporate constituencies will seek to renegotiate contracts as their bargaining power increases. Bargaining is likely to occur when constituencies have made firm-specific investments and are committed with significant sunk costs. In this situation it is tempting for other constituencies to take advantage of any bargaining power they may have. Ultimately, then, corporate governance can be seen as a system of bargaining.[107]

Changes in bargaining power will reflect overall changes in the political economy. Corporate constituencies are also interest groups that can use political means to further their own interests. Regulation can be seen as the outcome of the interaction between political and market structures, reflecting the impact of interested market participants and the political environment.[108] Changes in regulation can be seen to reflect changes in the relative bargaining power of these constituencies. In other words, the relationship between shareholders and managers will be renegotiated, in part, through political and regulatory intervention, depending on how the relative political bargaining power of these constituencies evolves. In this respect, corporate law and

[106] *See* Perotti & von Thadden (2004), *supra* note 14; *see also* Gourevitch & Shinn (2005), *supra* note 12, at 8.
[107] Peter Nobel, *Stakeholders and the legal Theory of the Corporation*, in PERSPECTIVES IN COMPANY LAW AND FINANCIAL REGULATION 165, 176 - 179 (Michel Tison, Hans de Wulf, Christoph van der Elst & Reinhard Steennot, eds., 2009).
[108] *See* Stigler (1971), *supra* note 10, Peltzman (1976), *supra* note 10, Roe (2000), *supra* note 10 and Roe (2003), *supra* note 10.

corporate governance regulation can be expected to reflect the institutional power of dominant corporate constituencies. [109]

Corporations and the way they are governed are of considerable economic importance. Corporate governance has a significant effect on the preconditions for the creation of wealth and economic growth, as well as on the distribution of cash flows and profits from corporate enterprise. It is but natural that corporate governance should have considerable political implications, as key corporate constituencies agree and renegotiate their relationships through the political framework. For example, in markets with a prevalence of concentrated ownership, corporate governance regulation can be expected to favor blockholders. In markets with dispersed ownership, where shareholders face coordination problems, corporate governance can be expected to favor management. In this regard, labor is also a significant corporate constituency, often with considerable political clout. In basic agency analysis, labor is sometimes excluded as an external constituency, as contracts between the company and labor are assumed to be complete. [110] However, these contracts are often renegotiated on the basis of the relative bargaining power of unions. For example, if the role of labor increases significantly in the production chain, this can be expected to affect corporate governance solutions. It has been argued that the strong position of labor has had a significant effect among EU countries, with Germany cited as a prime example. [111] Creditors are another external constituency, along with employees, that also has significant interests in corporate governance that can be pursued through policy and regulation. In particular, in economies with a financial system dominated by financial intermediaries, such as banks, the role of external creditors in corporate governance has been significant.

In the vast majority of cases, political economies are sufficiently complex to avoid domination by single political interests. In other words, a single constituency is rarely in the position to dictate policy. Gourevitch & Shinn have assessed the potential for political coalitions between different key corporate constituencies.[112] Different constituencies can seek to bargain with each other, or if interests are insufficiently uniform within a group, their political influence can be divided. Gourevitch & Shinn identified the key interests of each constituency and assessed to what extent and in which circumstances two constituencies might form a political coalition in terms of corporate governance regulation. [113] They identified three models for political conflicts and coalition preferences in different types of economies. First, the class conflict model posits shareholders ("owners of capital") in conflict with employees ("workers") with labor power. In this model, management is expected to form a coalition with shareholders.[114] If investors are politically dominant, this model will lead to strong minority protection and dispersed ownership. However, in economies where employees are dominant, there will be pressure on companies to provide higher salaries and job security at the cost of maximizing profits. As proposed by Roe, strong labor calls for a controlling shareholder with whom it can negotiate, giving concentrated ownership structures an overall relative advantage in that economy.

---

[109] John Armour, Henry Hansmann & Reinier Kraakman, *What is Corporate Law? in* Kraakman et al. (2009), *supra* note 11, at 32.
[110] Gourevitch & Shinn (2005), *supra* note 13, at 8.
[111] *Id.*
[112] *Id.*
[113] *Id.* at 57-68.
[114] See Michael Hiscox, *Class versus Industry Cleavages: Inter-Industry Factor Mobility and the Politics of Trade*, 50 INTERNATIONAL ORGANIZATION 1 (2001).

Second, in the sectoral cleavage model, constituents with asset-specific investments form political coalitions to protect their investment. In this model, employees and managers cooperate to protect their interests in the company and in the industry in general. An example of this model is the "Corporatist Compromise,"[115] where managers and employees cooperate to promote stability, the size of the corporation and insiders' claims on corporate income.[116] Here, the regulatory framework is expected to promote stability, with rules favorable to block-holders and strong employee protection. Minority shareholder protection will not be strong.

The third model sees shareholders and employees combining their interests to constrain managerial agency costs. Employees support shareholders with regard to corporate power but are compensated through job security. Alternatively, employees can have interests aligned with shareholders in the form of pension fund investments. The preferences of labor will be affected by how the pension system is structured. For example, the more social security and pensions are funded on a pay-as-you-go basis, the less of a connection is perceived between corporate governance and future benefit streams. The more pensions are based on fully funded models and the more benefits are linked to investment returns, the greater the connection to corporate governance.[117]

In what follows, I will turn to analyzing Nordic corporate governance in the light of dominant political coalitions. On a general level, those Nordic countries with concentrated ownership display evidence of political coalitions between managers and workers on one side and controlling shareholders on the other.[118] The outcome has been, among others, a broad corporatist agreement on determining wage levels and terms of employment. However, it has been argued that in exchange for job security, blockholders have been allowed considerable latitude with respect to corporate governance in general, and with respect to corporate control in particular. We shall seek to establish the extent to which this is the case and see how coalitions are reflected in the Nordic model of corporate governance regulation.

B. THE CORPORATION IN A NORDIC CONTEXT

Generalizations tend to be inaccurate, and the extent to which there really is a common Nordic model of corporate governance can well be questioned. Even if there are similarities between the corporate laws of the Nordic countries, it seems that differences remain in these countries' political economies that affect the dynamics of corporate governance. Institutional investors, for example, have been more vocal in corporate governance matters in Sweden than in other Nordic countries, resulting, in practice, in comprehensive self-regulation and stringent requirements on the equal treatment of shareholders – phenomena that are not as pronounced in the other Nordic economies. Nevertheless, academics in the Nordic region do identify certain common characteristics in the Nordic model that will be briefly discussed below.[119] First, however, this section outlines the basic legal structure of the corporation in the Nordic context to establish the

[115] Gourevitch & Shinn (2005), *supra* note 13, at 64-65.
[116] *See* Marco Pagano & Paolo Volpin, *The Political Economy of Corporate Governance* (Centre for Economic Policy Research Discussion Paper No. *2682*, 2001), *available at* http://www.csef.it/pagano/AER-2005.pdf.
[117] Gourevitch & Shinn (2005), *supra* note 13, at 215.
[118] *Id.* at 141.
[119] Hansen, *supra* note 4, at 1-3.

premises for how corporate governance can affect the relative position of different corporate constituencies.

1. Legal Structures

The corporation is a legally and socially defined platform for organizing the conduct of economic activity. The type of corporation portrayed in this study has largely evolved as a product of financial markets to organize the financing of economic activity in a cost-efficient and reliable way. Certain specified assets and liabilities are separated for the purposes of producing economic activity that generates cash flows that are distributed to corporate constituents according to applicable contractual and regulatory arrangements.

The structure and regulation of business corporations is based on laws and regulations and varies from country to country, but in an international and comparative context, certain common characteristics given to corporations in the laws of most jurisdictions have been identified in the legal literature.[120] First, corporations have generally been given independent legal personality. The corporation is given legal status as an independent contracting party with distinct assets and liabilities. Second, the corporation as a separate entity from its shareholders or officers assumes liability for its obligations and these are, as a rule, not passed on. Third, shares in corporations are transferable, so that shareholding is not linked to a specific person or party, as in connection with membership in associations or cooperatives, for example. Fourth, the management of corporations is delegated from shareholders to a board of directors, who act separately from the operational management. Fifth, and finally, corporations are characterized by investor ownership, meaning that shareholders who have invested in a company have the right to residual cash flows from its operations and also have the right to control the corporation – within the limits of the obligations undertaken by that corporation.

The independent legal personality of the corporation, the partitioning of its assets and the lock-in of injected capital form the core of what a company is, and they may be an important aspect of its institutional success.[121] While shareholders enjoy limited liability, it is equally important that the assets of the corporation are protected from shareholders' creditors and that shareholders are prevented from withdrawing their share of the corporate assets at will. The lock-in serves to provide comfort for creditors and other parties dealing with the corporation. In the Nordic countries, creditor protection has been a particularly important factor, given the traditional dominance of banks in the financial markets (Until recently, for example, Nordic company laws have typically maintained the nominal value of shares and liquidity-driven bankruptcy provisions in such a way that a decrease in a company's own capital would force the company into insolvency proceedings). Corporate legal personality also has a strong tradition in the Nordic countries, with little precedent for "piercing the corporate veil."

The transferability of shares is another basic characteristic of a corporation, underscoring the separation of the corporation from its owners. Ownership is not linked to the identity of the owners, and the corporation's business can continue without interruption despite changes in

---

[120] Armour, Hansmann & Kraakman in Kraakman et. al., *supra* note 109, at 5-16.

[121] *See* Henry Hansmann, Reinier Kraakman & Richard Squire, *Law and the Rise of the Firm*, 119 HARVARD L.R. 1333, 2006 and Margareth Blair & Lyn Stout, *Specific Investment and Corporate Law*, EUROPEAN BUSINESS ORGANIZATION L.R. 7, 2006, 495 – 496.

ultimate ownership. It is important to emphasize, in fact, that while shareholders are often referred to as the owners of a corporation, what they actually "own" are only the shares issued by the corporation, which give them certain administrative and cash flow rights based on company law and the articles of association of the company. These rights are balanced, based in part on law, with the interests of other constituencies. The framework by which this balance is regulated is the central focus area of corporate governance. While the other characteristics of corporations are fairly similar around the world, the allocation of corporate control and authority can be organized in a variety of ways, reflecting the political characteristics of corporate governance. [122]

The lock-in of capital and restrictions on shareholder access to corporate assets provide the basis for the potential reallocation of wealth through corporate governance and for the effects of regulatory and political intervention. The legal structure of the corporation includes features that allow for a redistribution of wealth among corporate constituencies based on their political influence. The outcome of such bargaining will depend on the relevant political economy. Corporate constituencies can take advantage of the political system to renegotiate the terms of how corporate assets are allocated between corporate constituencies and the extent of shareholder rights, for example. The distribution of wealth can be affected, inter alia, by the distribution of control rights in the company. Thus, the corporate governance structure applicable to the company is of considerable importance with respect to the interests of the different constituencies. Moreover, these interests can be pursued by other political means. Employee regulation and different types of social regulation applied to corporations are obvious examples.

The extent to which a specific structure of corporate governance reflects shareholder primacy or supports the interests of other stakeholders will depend on political bargaining. In some economies shareholder supremacy in corporate governance is a given, while in others labor interests, or those of creditors, for example, play an important role. There is no guarantee that the way these interests are balanced is optimal or efficient within the institutional environment, as has been discussed. The effects of path dependence and entrenchment of incumbent interests suggests that these structures may easily come to favor specific interest groups at the cost of efficiency.

It has been argued that the corporate governance solutions adopted in the Nordic countries somehow reflect a "particularly effective middle way"[123] between Anglo-Saxon shareholder-oriented systems and traditional German stakeholder-oriented systems in favoring shareholder supremacy while providing protection for other stakeholders, including minority shareholders, creditors and employees.[124] The study shall now turn to a brief overview of corporate governance in the Nordic countries and consider whether in fact it reflects a "middle way" and how such a system has come about.

2. Elements of Corporate Governance in the Nordic Countries

Below, the study will briefly consider some of the central elements of corporate governance in the Nordic countries based on formal corporate governance structures. The study will then consider how these structures reflect the political aspects of corporate ownership, control and

[122] Barker (2010), *supra* note 10, at 3.
[123] Hansen (2003), *supra* note 4, at 1.
[124] *Id.*

corporate governance. The study will explore how formal structures reflect the influence of controlling shareholders, what the position of management is and how employees can participate in governance and how their interests are taken into account. With regard to corporate governance, key characteristics include the formal position of shareholders and how shareholders can use their authority, the relationship between majority and minority shareholders, the role and power of boards of directors, other control mechanisms applied to corporate monitoring as well as transparency.

Both Sweden and Finland have somewhat recently implemented reforms of corporate law – Sweden in 2005 and Finland in 2006.[125] The new laws were introduced following the decline of traditional models of corporate finance and corporate ownership and reflect an interest in modernizing corporate law and increasing investor protection and the interests of minority shareholders.[126] The corporate governance models one might expect to see, then, would strengthen shareholder primacy and address block-holding related concerns, particularly as the corporate landscape is still somewhat dominated by concentrated ownership. Below, this study will discuss from a qualitative perspective the main mechanisms identified in the indices referred to above and seek to establish how the Nordic model fares.

Shareholders

The Nordic model of corporate governance has been described as hierarchical, with the general meeting of shareholders having supreme authority over other corporate bodies.[127] The general meeting has the authority to take key decisions regarding the company, from approving annual financial statements to decisions regarding key corporate transactions, such as mergers, and electing and dismissing the board of directors. For example, under Nordic corporate laws, the general meeting of shareholders always has the right to elect the majority of the board of directors. Other decisions taken by the general meeting include changing the articles of association, issuance of shares (or authorizing the board to issue shares), acquisition of the company's own shares and liquidation of the company.

Through election and dismissal rights, in particular, the general meeting of shareholders can be seen to exercise control over other corporate bodies even if the general meeting is not generally intended to have executive powers. It is also worth noting that staggered boards are typically not allowed under Nordic company laws. Thus, a general meeting is usually able to dismiss the board at any time – emphasizing the control of shareholders over management and the board of directors. The balance of power differs significantly from the more director-centric system in the United States, for example.

Decisions at shareholders' meetings are generally taken with a simple majority vote. Cumulative voting or similar election systems are typically not applied. Decisions on significant corporate transactions, such as mergers or changes of articles of association, typically require a minimum

---

[125] Ny aktiebolagslag, Regeringens Proposition [New Companies Act, Government Bill] 2004/05:85, at 196-200, and Hallituksen esitys Eduskunnalle uudeksi osakeyhtiölainsäädännöksi [Government Bill for New Company Legislation] 109/2005, at 16-17.
[126] Jukka Mähönen, *The Finnish Position on Corporate Governance* in STUDIES ON THE FINNISH LEGAL SYSTEM 38, 41-42 (Erkki J. Hollo ed., 2011).
[127] Hansen (2003), *supra* note 4, at 74.

of two thirds of the votes given and the shares represented at the meeting. It should be pointed out, in particular, that where companies have different classes of shares, major corporate transactions must typically be approved by a qualified majority of the shares and votes in each class.

It should also be noted that quorum requirements for shareholder meetings are unusual, and for decisions to be passed it is generally sufficient that the relevant majorities of the shares present support the decision in question. However, in cases pertaining to a change of rights related to shares, company law typically also requires the holders of the affected shares to support the decision.

Minority Shareholder Protection

The principle of equal treatment is a central element in Nordic company law. Company law in Finland and Sweden, for example, contains explicit provisions on the requirement that no decisions can be taken by corporate bodies (the general meeting or the board) that favor a shareholder or a third party at the expense of the company or the other shareholders.[128] It is also the case that board members, pursuant to company law, can be directly liable to shareholders for decisions that would unduly disadvantage the minority.[129] The principle can have practical implications with regard to the types of corporate transactions companies can pursue.

Decisions regarding decisive corporate transactions require qualified majority support. Thus, groups of minority shareholders can veto the decisions of a controlling majority with respect to changes of articles of association, or mergers and directed share offerings. In connection with certain transactions, minority shareholders may also have the right to require that their shares be redeemed at fair value. This is the case in mergers and demergers in Finnish companies, for example.

In the Nordic countries, any shareholder can generally submit a proposal to a general meeting of shareholders and can raise counterproposals to those made by the board. Shareholders have the right to ask questions at the general meeting and the management has a statutory obligation to provide answers (within certain parameters so as not to divulge trade secrets or other sensitive information). In Finland and Sweden, shareholders with an aggregate of 10 percent of the shares in a company can require the convening of a general meeting of shareholders or a special audit carried out by an auditor for a specific purpose.[130] Moreover, in Finland and Sweden shareholders with a 10 percent holding can require a dividend payment of half of the profits available for distribution from the last financial period.[131] In this regard, again, the system of governance

[128] CLAS BERGSTRÖM & PER SAMUELSSON, AKTIEBOLAGETS GRUNDPROBLEM [BASIC PROBLEMS OF THE STOCK COMPANY] 168-174 (4th ed. 2013); 1 JUHANI KYLÄKALLIO, OLLI IIROLA & KALLE KYLÄKALLIO, OSAKEYHTIÖ [THE STOCK COMPANY] 537-542 (5th ed. 2012); Hansen (2003), *supra* note 4, at 104-105.

[129] ROLF DOTEVALL, BOLAGSLEDNINGENS SKADESTÅNDSANSVAR [THE LIABILITY OF CORPORATE MANAGEMENT] 231 (2nd ed. 2008), Kyläkallio, Iirola & Kyläkallio, *supra* note 138, at 566-573, Hansen (2003), *supra* note 4, at 118.

[130] Aktiebolagslagen [Swedish Companies Act] 7:13 and 10:21-23, and Osakeyhtiölaki [Finnish Companies Act] 5:4 and 7:7.

[131] Swedish Companies Act 18:11 and Finnish Companies Act 13:7.

differs markedly from the United States, where it has been unusual for shareholder initiatives to be favored in corporate governance.[132]

The Board of Directors and Management

The central administrative company organ is the board of directors, which has the overall authority and responsibility to arrange the management of the company. In many respects, the board retains executive powers and can also direct the executive management. The importance of the fiduciary duties of the board to the shareholders as a collective has increased over the past decade. In Finland, for example, this has been explicitly stated in preparatory works with respect to change of control situations.[133] Furthermore, as shareholders have the right to elect the majority of the board, it can generally be deemed an organ representing the interests of the shareholders. When a company has a controlling shareholder, the accountability of the board can be very direct.[134]

Boards of directors in listed companies generally consist solely of non-executive directors, with the occasional exception of a chief executive officer, or CEO, who also serves as a board member. Codes of corporate governance for listed companies also provide additional requirements for board members. Requirements have been introduced with respect to the independence of company board members and large shareholders. In Finland, for example, more than half the board members of a listed company must be independent of the company (i.e., not having been recently employed by the company) and two of these independent members must also be independent of large shareholders. Similar rules apply in the other Nordic countries.[135]

The board is separated from the day to day management of the company but is responsible for ensuring that sufficient administrative systems are in place and for monitoring corporate performance vis-a-vis the strategies it has confirmed. Governance principles, policies and risk management are issues that boards typically manage, as well as monitoring periodic reporting and approving interim and annual financial statements. Large corporate projects are also typically in the domain of the board.[136]

Board structures in the Nordic countries generally fall into the single-tier model of governance, even if corporate laws in these countries formally recognize different management layers.[137] The board is clearly superior to the management and CEO in administrative terms, with the right to appoint and dismiss the CEO. In Finland, a two-tier model of governance with a supervisory board is also possible. However, supervisory boards are increasingly rare and usually have

[132] *See* Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005).
[133] Government Bill for New Company Legislation 109/2005, at 41.
[134] *See* Bergström & Samuelsson (2012), *supra* note 128, at 99.
[135] Securities Markets Association, Suomen listayhtiöiden hallinnointikoodi [Finnish Corporate Governance Code], Recommendations 14 and 15 (2010); *see also* Danish Corporate Governance Committee, Finnish Securities Market Association, Icelandic Committee on Corporate Governance, Norwegian Corporate Governance Board, Swedish Corporate Governance Board, *Corporate Governance in the Nordic Countries* (2009).
[136] Bergström & Samuelsson (2012), *supra* note 128, at 95-97; Kyläkallio, Iirola & Kyläkallio (2012), *supra* note 128, at 557-558; Hansen (2003), *supra* note 4, at 116-118.
[137] *See* Jesper Lau Hansen, *The Nordic Corporate Governance Model – A European Model?* in Tison, de Wulf, van der Elst & Steennot, eds. (2009), supra note 107.

limited authority. Generally, this structure emphasizes the primacy of shareholders over other stakeholders with respect to corporate control.

The day to day administration of the company is delegated to employed management. Typically, a management team works under the supervision of the CEO, who reports to the board and takes directions from it. It should be noted that management still has formal status in company law to a limited extent, though in most Nordic countries management as a formal company organ is limited to the CEO only.[138] In their analysis of corporate power in Sweden, Henrekson & Jakobson argue that management has a relatively weak position in relation to shareholders. In reality the CEO must have the backing of large shareholders in order to remain in his or her position.

Employees

The Nordic countries have also adopted laws on allowing employees the right to nominate representatives to the board (or management committees). The rules vary from country to country, with some allowing employees actual board representation (Denmark and Sweden), others observer status (Norway) and others still participation in other organs than the board (Finland).[139] In Denmark, Norway and Sweden employees in larger companies have the right to nominate their representatives to the board. Pursuant to Swedish law, for example, employees have the right to nominate two board members in companies with over 25 employees and three representatives if the company has an annual average of at least 1,000 employees.[140] The number of employee-nominated board members must not to exceed that of the other members, however. In Norway, the number of employee-elected members is set at half of those elected by shareholders. Consequently employee representatives have a minority position and cannot directly affect the outcome of board decisions. In fact, a recent study finds evidence that shareholders seek to minimize the number of employee-elected board members.[141] In Finland, employees have no statutory right to nominate representatives to the company's board of directors. However, employees do have the right to nominate representatives to management groups where matters related to employee issues are discussed.[142] Often companies ensure they are in technical compliance with the requirement by having two different management boards, for example, one of which is tailored to meet these legal requirements.

Employee legislation can also be seen as an integral part of balancing the interests between corporate constituencies, even if employee legislation is seldom considered directly related to corporate governance. However, Nordic countries have adopted regulation on cooperation measures that must be undertaken between management and employees. Generally, larger companies must have works councils or similar organizations, where matters pertaining to the company's business and financial condition are discussed on an on-going basis. Moreover, in

[138] *Id.*
[139] Hansen (2003), *supra* note 4, at 76.
[140] Lag om styrelserepresentation för de privatanställda [Board Representation Act] 1987:1245.
[141] Steen Thomsen, Caspar Rose & Dorte Kronborg, *Employee Representation and Board Size in the Nordic Countries* (DBJ Discussion Paper Series 1301, 2013), *available at* http://www.dbj.jp/ricf/pdf/research/DBJ_DP_1301.pdf.
[142] Laki henkilöstön edustuksesta yritysten hallinnossa [Act on Employee Representation on Company Administration] 1990/725.

connection with corporate transactions that can affect employment in the company, there are usually specific requirements for negotiations and cooperation processes that must be followed prior to any decisions on the matter.[143]

Other Monitoring Mechanisms

Auditors also perform a monitoring function on behalf of shareholders in the Nordic countries. For example, statutory auditors are appointed by the general meeting rather than the board and report back to the shareholders. Auditors generally provide an assessment and recommendation to the annual general meeting on whether the financial statements and board proposals regarding profit or loss can be adopted. In Finland and Sweden the activities of the board and management are also subject to an auditors' review.

The four Nordic countries have all adopted corporate governance codes for listed companies in line with other EU jurisdictions. The codes set out procedures for governance and transparency beyond the requirements of national company law. These codes typically include provisions on the organization of board work, board committees and the policies that companies should draw up, as well as procedures and guidance for shareholder participation in general meetings. The codes also provide requirements on the independence of board members and board committees. Finally, the codes provide requirements for increased transparency with regard to matters to be dealt with at general meetings, remuneration issues, and governance principles. The establishment of corporate governance codes is generally based on self-regulation rather than statutory provisions.

C. THE POLITICAL ASPECTS OF THE NORDIC MODEL OF GOVERNANCE

Having first outlined theories emphasizing the political aspects of corporate governance regulation and having then described its formal aspects, I will now examine how the Nordic model of corporate governance reflects these assumptions – i.e., whether the political coalitions that can be established in the Nordics coincide with the form of ownership and control and related regulation that the theories assume.

With the prevalence of concentrated ownership and strong labor movements in the Nordics, political coalitions could be expected to form between controlling shareholders and labor. Thus, the political approach to corporate governance described above suggests that Nordic corporate governance should favor shareholder primacy and blockholder control. Unsurprisingly then, Nordic corporate governance models are based on shareholder primacy. The system ensures controlling shareholders' ability to maintain their control rights in corporations. As discussed above, the general meeting of shareholders is deemed to have considerable influence over corporate affairs in Nordic company law in relation to the role of the board.[144] Hansen emphasizes the ability of the general meeting (and thus the controlling shareholder) to appoint and dismiss the board of directors and the absence of staggered board provisions, for example. Moreover, it should be noted that the kind of restrictions on shareholder collusion in connection

[143] See Örjan Edström, *Involvement of Employees in Private Enterprises in Four Nordic Countries*, 43 SCANDINAVIAN STUDIES IN LAW 159 (2002).
[144] Hansen (2003), *supra* note 4, at 73-75; Hansen (2009), *supra* note 149, at 161.

with general meetings applied in the United States and the United Kingdom are not generally present in the Nordic countries.[145]

It should also be noted that in Sweden, in particular, shareholders typically establish nomination committees (or nomination boards) consisting of representatives of the largest shareholders to make proposals for new board members to the annual general meeting. In many other jurisdictions, nomination committees are maintained within the board structure. The Swedish practice is another reflection of the strong position and influence of both controlling and institutional shareholders. The acceptance and prevalence of different types of control-enhancing mechanisms also demonstrates how regulation can be said to particularly support block holders in the Nordic countries.

As discussed earlier, in an environment with concentrated ownership and strong labor interests, minority protection mechanisms could be expected to be generally weak. Nevertheless, it is often argued that Nordic company law provides a high level of protection for minority shareholders.[146] The minority protection mechanisms allow minority shareholders to voice their concerns at the general meeting, and they provide for a certain level of information that must be made available. Nonetheless, minority shareholders have very few effective control rights in relation to controlling shareholders. A controlling shareholder can generally control corporate decision-making and is only restricted with respect to situations where there is a risk of the economic interests of minority shareholders being abused. In addition, minority shareholders naturally face coordination problems with respect to the use of their limited governance rights.

Legal standards, such as the equal treatment principle, are based on ex-post enforcement by actions initiated by aggrieved parties. As a regulatory strategy, such tools are problematic with respect to large, diverse interest groups with a high threshold for coordinating their activities.[147] With respect to enforcing standards or claiming for damages, minority shareholders must turn to the courts and bear the full risk of the costs in the event of losing the case, while expecting only limited benefits from a successful claim. Even if legal costs are relatively low in the Nordic countries, the losing party typically pays the legal fees of the other party as well. Moreover, class actions or punitive damages are not generally available for these types of situations. Even if the equal treatment principle and other standards of company law are important and do have an effect on corporate activities in the Nordic region, they should not be overemphasized in the context of corporate governance for the abovementioned reasons.

There are nevertheless limited incentives for large shareholders to seek to directly extract private benefits of control at the cost of minority shareholders. Maintaining concentrated ownership is relatively cheap in the Nordic countries, and controlling shareholders are compensated for their holdings in part through the tax system.[148] First, control-enhancing mechanisms can be used to leverage control at low levels of equity ownership. Thus, maintaining control does not tie up as much capital, thus decreasing the need to extract private benefits. Second, the pecking order of financing is further enforced by the favorable tax treatment of corporate finance based on

[145] *See* Bebchuk (2005), *supra* note 132.
[146] Bergström & Samuelsson (2012), *supra* note 128, at 193; Hansen (2009), *supra* note 137, at 155 and 161.
[147] Armour, Hansmann & Kraakman, *supra* note 11, at 52.
[148] Högfeldt (2005), *supra* note 30, at 555.

retained earnings and debt. Consequently, controlling shareholders are often able to finance the operations and investments of the companies they control without further equity investments. Third, distributing dividends to controlling shareholders using control enhancing mechanisms, such as pyramids, are typically tax-efficient.[149] As a result, controlling shareholders receive relative benefits from large holdings through the institutional environment, and there is no direct need to extract significant private benefits from the minority.

Labor has traditionally formed an important political force in the Nordic countries. Thus, it would be reasonable to expect labor interests to be represented in company law and corporate governance. With the political power that labor has wielded, employee representatives might well hold key positions in corporate decision-making, as has been the situation in Germany. However, as discussed above, there seems to have developed a balance wherein corporate control has been allocated to (controlling) shareholders against fairly high levels of job protection in the Nordic countries. This arrangement has gained the political support of both right-leaning and left-leaning governments. Högfeldt suggests that the arrangement is based on an implicit undertaking by the incumbent controlling shareholders to maintain domestic corporate activity and investments.[150] While this undertaking has been undermined by globalization, among others, employee interests have also shifted towards greater minority protection rather than towards requiring more of a voice in corporate governance.

As was previously discussed, employees have generally enjoyed high levels of job protection in the Nordic countries. In Sweden, for example, the rule on termination for industrial and commercial reasons provides that employees must be let go on a last in, first out principle, thus protecting more experienced "inside" labor. The impracticality of the rule guarantees that in most cases termination is agreed amicably between the employer and employee representatives, providing for higher levels of employee compensation. High levels of job protection combined with satisfactory social programs and unemployment benefits for insider labor have also decreased pressure for labor to acquire more of a voice in corporate governance.

D. The Evolving Political Economy and Corporate Governance in the Nordic Countries

Above, I discussed how models of Nordic corporate governance reflect the structure of corporate ownership and dominant political coalitions. However, the traditional Nordic model of corporate governance has evolved significantly over the past decades. The dominance enjoyed by incumbent shareholders in previous decades has decreased as markets have become more international. Globalization and technological innovation have also affected industrial structures. From a focus on raw-material-based industries and machinery, the Nordic countries now also have large technology, media and service industries. These developments have affected corporate ownership and corporate governance. Despite the path dependence of regulation, one might expect to see these developments reflected in recent corporate governance initiatives. Some of the key factors contributing to this development are discussed briefly below, followed by some conclusions on possible current trends in Nordic corporate governance.

[149] *Id.*
[150] *Id.* at 554.

1. Pension Systems and Corporate Governance

Pension systems have a significant influence on corporate governance.[151] Many pension systems rely on different types of contribution schemes. A large part of pensions may be unfunded, with benefits paid directly from contributions. However, systems increasingly include buffer funds based on capital market investments. Finally, individual pension plans are typically fully funded programs. To the extent that pension systems rely on income from capital markets, the interests of pension beneficiaries become aligned with those of investors. As pension beneficiaries represent large and influential constituencies, their interests are politically significant. This can be reflected in regulatory initiatives regarding corporate governance.

There has been an increasing focus on the relationship between pension systems and shareholder primacy in corporate governance.[152] As pension plans shift from depending primarily on an employer's funding ability towards capital-markets-based funding, shareholder interests have become more important for large groups in society. As a result, shareholder interests are of increasing importance relative to labor-oriented policies.

Sweden

In Sweden a comprehensive pension reform was initiated in 2000 which increased the holdings of pension funds in Swedish listed companies. With this development comes an increasing interest in corporate governance solutions that reflect the interests of minority shareholders.[153] As a result of the reform, a pension scheme based on a prefunded, defined benefit system was changed to a partially funded, notionally defined contribution scheme. Most pension contributions are directed to "pay-as-you-go," notionally defined contribution accounts, but some are directed to private investment reserve funds,[154] with large public pension funds holding the most assets (referred to as *AP-fonderna*).

Giannetti & Laeven view the Swedish pension reform as an exogenous shock to the structure of corporate ownership and corporate governance in Sweden.[155] The reallocation of assets and the new inflow of funds into public and private pension funds allowed the authors to analyze how changes in the structure of institutional ownership affect company performance.[156] They found that the effect on company value varies according to the characteristics and industrial structure of pension funds. As funds issuing from business groups can be used to entrench corporate control, their increased holdings do not contribute to corporate value. However, investments by large public or independent pension funds do have a correlation with increased value.[157]

---

[151] See Gourevitch & Shinn (2005), *supra* note 13, at 210-228.

[152] *See* Martin Gelter, *The Pension System and the Rise of Shareholder Primacy* (Fordham University School of Law Working Paper Series, 2012) *available at* http://ssrn.com/abstract=2079607.

[153] *See* Mariassunta Giannetti & Luc Laeven, *Pension Reform, Ownership Structure, and Corporate Governance: Evidence From a Natural Experiment*, 22 THE REVIEW OF FINANCIAL STUDIES 4091 (2009).

[154] Edward Palmer, *Swedish Pension Reform, How Did It Evolve, and What Does It Mean for the Future? in* SOCIAL SECURITY PENSION REFORM IN EUROPE 171 (Martin Feldstein & Horst Siebert, Eds., 2002).

[155] *See* Giannetti & Laeven, *supra* note 153.

[156] *Id. at* 4092.

[157] *Id. at* 4112.

Pension funds have become active participants in the Swedish market. With significant holdings and generally long-term investment strategies, they are likely to prefer contributing to corporate governance instead of selling their holdings if dissatisfied with a company's performance.[158] The increased focus of institutional investors on corporate governance can enhance scrutiny of controlling shareholders, thus decreasing private benefits of control. However, it is also possible for controlling shareholders to attempt to resist monitoring and take steps to ensure continued control. In fact, in their study Giannetti & Laeven observed that control premiums had risen in certain cases where public pension funds had increased their positions, which suggests that ownership concentration has increased. The authors found that company-controlled pension funds, for example, had increased their holdings as a reaction to an increase in the stake of public pension funds, which has allowed incumbent owners to entrench their control positions.[159]

With respect to corporate governance, pension funds can function as monitors of controlling shareholders with significant political authority. The value of pension fund investments is of course of some importance to the beneficiaries and can align their interests with those of other institutional and minority investors with respect to corporate governance.[160] If needed, pension funds have the potential to mobilize political support for regulatory intervention to increase minority protection with greater ease than other investors without the same political backing. While pension funds may allow controlling shareholders to retain operational control, as the institutional framework in Sweden supports a block-holding system,[161] there is likely to be considerable pressure on controlling shareholders to extract only very limited private benefits of control. If control still has value to the incumbent owners, they may agree to higher minority protection mechanisms as long as control is not challenged.

Finland

The pension system in Finland has also undergone significant developments during the past two decades. The system is partially funded, with the majority of funding still based on pay-as-you-go contributions.[162] The pension system is statutory and closely regulated but managed by private pension insurance companies. Previously, a significant feature of the pension system was the availability of pension funds to corporations as loans. The developments of the past decades have resulted in a stronger emphasis on equity investments and international diversification – though pension funds still have abnormally large exposure to Finnish equities.[163] This is due, so it is suggested, to the perceived dual role of pension funds, which is not only to secure pension income but also to contribute to the stability of the Finnish economy. Due to the small size of the domestic market, the liquidity of these assets is relatively poor. It has also been suggested that

---

[158] *Id. at* 4099.
[159] *Id. at* 4125.
[160] Gourevitch & Shinn (2005), *supra* note 13, at 145-146 and 213-228.
[161] Henrekson & Jakobsson (2012), *supra* note 38.
[162] Jukka Lassila & Tarmo Valkonen, *Prefunding in a Defined Benefit Pension System: The Finnish Case*, in SOCIAL SECURITY PENSION REFORM IN EUROPE 263, 263 (Martin Feldstein & Horst Siebert, eds., 2002).
[163] *See* Keith Ambachtsheer, *The Pension System in Finland: Institutional Structure and Governance* (Evaluation of the Finnish Pension System, Part 2, Finnish Centre of Pensions, 2013) *available at* http://develop.fafo.no/files/news/12459/the_pension_system_in_finland_institutional_structure_and_governance_7.pdf.

Finnish equities are overvalued as a result of pension funds' disproportionate investment in Finland.

In relation to size of the market, the holdings of Finnish pension insurance institutions in Finnish listed companies are considerable. With respect to corporate governance, Finnish pension institutions have taken active roles in both on-going governance (board nomination processes and annual general meetings) and corporate transactions. Due to their large size, pension insurance companies are often involved in the preparatory phase of significant transactions. However, the dynamic of these relationships may be different from that in Sweden, where pension funds are often essentially public entities. In Finland corporations are in fact clients of Finnish pension insurance companies, and it has been suggested that Finnish pension insurance companies are typically aligned with management interests. In fact, the governing bodies of pension insurance companies include employer and union representatives based on statute. Pension insurance companies have, for example, even prevented takeover bids at premiums or voiced their support for management in proposed corporate coups.[164] It has been suggested that the relationships between pension insurance companies and corporations are not always at arm's length.[165] This implies that the increased equity stakes of pension insurance companies and their participation in corporate governance may not have the same effects as in Sweden – i.e. they may not have such a clear agenda to strengthen the interests of minority shareholders.

2. Globalization and Increasing Product Market Competition

Increases in foreign ownership have had crucial effect on corporate governance in the Nordic countries over the past decades. In Sweden, foreign ownership has increased from eight percent in the mid-1980s to over 40 percent in 2012.[166] In Finland, foreign share ownership was 36.6 percent in 1996 and over 60 percent in 2007,[167] although it had decreased to just over 41 percent by the end of 2012. [168]Finnish statistics for this period are somewhat skewed, however, due to the disproportionate weight of a single company, Nokia Corporation.

With the increase in foreign ownership, the Nordic model of corporate governance has come under scrutiny, leading to its comparison with standards in other types of economies. As a large part of foreign investment originates from the United States and the United Kingdom, the corporate governance models in these countries have of course become benchmarks against which the Nordic model has been compared. Incumbent controlling shareholders can be expected to resist attempts to restrict their control rights through corporate governance initiatives of any kind. However, they could be expected accept a higher level of transparency with regard to corporate governance matters, including related party transactions. Increased transparency does

---

[164] Ville-Pekka Sorsa & Antonios Roumpakis, *Nordic Welfare Financiers Made Global Portfolio Investors: Institutional Change in* Pension Fund Governance in Sweden and Finland (University of Oxford Working Papers in Employment, Work and Finance Wpg 10-01, 2010) 69, *available at* http://ssrn.com/abstract=1533376.
[165] Ambachtsheer (2013), *supra* note 163, at 46.
[166] Statistics Sweden, Ownership of Shares in Companies Quoted on Swedish Exchanges, *available at* http://www.scb.se/.
[167] FESE, Share Ownership Structure in Europe, December 2008.
[168] Bank of Finland, Pörssiosakkeiden Markkina-arvo ja ulkomaalaisomistus 31.1.1996 – 28.2.2011 [Market Value and Foreign Ownership of Listed Shares 31.1.1996 – 28.2.2011], *available at* http://www.suomenpankki.fi/en/tilastot/.

not interfere with the key concerns of incumbent owners. Moreover, transparency has generally attracted political support from labor interests as a tool against managerial opportunism. The EU Shareholders' Rights Directives can be seen as an outcome of this development, among others. As a result of the introduction of the directive, transparency has increased in Nordic listed companies. However, to date few initiatives have been introduced that restrict the decision-making rights of controlling shareholders.

It has been argued that open markets and product market competition provide an effective check on the possible opportunism of different corporate constituents. With effective competition, inefficient arrangements should be eliminated over time. As discussed, Nordic industry has been largely export driven. Thus, the markets have been subject to international product market competition, in turn explaining the relatively low private benefits of control despite a largely concentrated ownership structure. With globalization and the development of the EU internal market, international competition has further increased over the two past decades. As markets have become more competitive, labor interests have shifted from trying to extract rents to protecting jobs.[169] Labor will increasingly support steps that rationalize businesses, thereby securing the long-term job security of the workforce as a whole, even where that means lower wage increases or lay-offs. To some extent these effects have been mitigated by unemployment benefits and retraining or social programs that externalize the costs to society at large, but they also make it easier for a corporation to adapt to a changing environment through changes in the employee-structure.

3. Shifting Industrial Structures, Economic Crisis and the Influence of Labor Unions

Both Sweden and Finland experienced severe economic recession and a banking crisis in the early 1990s, following financial liberalization in the 1980s. This affected the political dynamic related to corporate regulation, as the influence of labor declined as a result of the severe industrial slump. Labor had little vested interest to defend, and no rents were available, leading to decreased resistance to change.[170] The banking crisis precipitated a change in corporate ownership that acted as a further catalyst for changes in corporate governance.[171]

In addition, the politics of unionized labor have also changed. Globalization and technological development have affected the industrial structure in the Nordic countries. Traditional economic engines, such as the paper and pulp industry in Finland and Sweden or the car industry in Sweden, have faced much tougher competition from abroad, forcing these industries to adapt. With increased competition, there have been no rents available for extraction and the focus of labor interests has shifted towards ensuring that the preconditions for continuing industrial production and employment opportunities are maintained. Unions have been forced to accept the new reality introduced by the globalized market place and have found new ways to promote the interests of their members. Many of the important new industries that have developed over the past decades, including technology-driven industries, have a different dynamic that does not support high levels of employee organization.[172] It has been argued that in this environment unions have been

---

[169] Gourevitch & Shinn (2005), *supra* note 13, *at* 210-211.
[170] Korkeamäki et al. (2007), *supra* note 17, at 9.
[171] Fellman (2008), *supra* note 70, at 191-199.
[172] *See* New Labour, Alt-Labour, *The Economist*, Sept. 14, 2013.

inclined to change their focus from seeking to obtain rents for their members to facilitating an orderly industrial evolution and looking to promote preconditions for competitive industrial activity.[173] This development usually leads to an increasing interest in transparency and enhanced minority interests to ensure proper managerial performance.[174]

4. The EU Regulatory Framework

The regulation of corporations is not solely a national matter, of course. The Nordic countries have traditionally had similar sources and structures of corporate law and even a tradition of joint legislative efforts, or at least a tendency to adopt legal solutions from other Nordic jurisdictions. Over the past decades, the impact of EU regulation has naturally had a significant effect on Nordic company law, leading also to a decrease in pan-Nordic initiatives to develop corporate law.

With respect to corporate governance and takeover regulation in EU member states, the EU regulatory framework has provided a new parallel avenue for regulatory change not subject to the same capture or dynamic as national regulation. The EU has introduced new dimensions to corporate governance regulation that can affect the bargaining power of corporate constituencies significantly. At the EU level, interest groups that are large and organized at the national level can be fragmented, and new groups that were too small at the national level to be able to organize can have sufficient critical mass to overcome coordination problems. The political dynamic of EU-level regulation differs from national regulation in small countries. Constituencies that may be able to promote their interests effectively at the national level may lack the clout to pursue their agendas at the EU level. The institutional structures prevalent in smaller EU economies may be more prone to change than the structures that dominate in economies with more influence in EU decision-making. Thus, EU regulation may have had a more extensive effect on traditional corporate governance structures in the Nordic countries than in larger EU member states.

The role of the EU in developing company law has evolved over the years. The EC Treaty provides the legal basis for pursuing harmonization and development of company law in order to reduce restrictions on the freedom of establishment pursuant to Article 44(2)(g) of the treaty, among others. Some company law initiatives have also been made under other provisions, such as Article 308, which allows appropriate means to be used for achieving the Community's goals.[175] It has been suggested that EU institutions have generally provided extensive interpretation of the powers granted by Article 44(2) and of the possibility of issuing corporate regulation on this basis. In fact, the number and focus of EU initiatives have often varied according to the current political and economic dynamic of European integration at any given period. Overall, EU level corporate regulation has not been particularly comprehensive, and earlier integration efforts, in particular, have been deemed rather insignificant.[176]

---

[173] Gourevitch & Shinn (2005), *supra* note 13, at 220-221.

[174] *Id.* at 221.

[175] Article 308 (formerly 235) was the basis for adopting the directive on the European company form, the "Societé Européenne", or "SE".

[176] *See* Luca Enriques, *EC Company Law Directives and Regulations: How Trivial Are They?*, 27 U.PA.J. INT'L.EC.L. 1 (2006).

The EU company law directives, however, form a common basis for the type of corporations discussed in this study. The earlier directives focused on some the basic characteristics of corporations, including corporate disclosures,[177] minimum share capital[178] and annual accounts[179] and audits.[180] Other company law directives have focused on corporate transactions with EU-wide aspects, such as cross-border mergers[181] and takeovers.[182] For the purposes of this study, it is relevant to focus on EU corporate governance initiatives and EU-level regulation addressing the interests or rights of corporate constituencies. Some of the key instruments in this regard include the Shareholder Rights Directive,[183] the Takeover Directive and the more recent EU Company Law Action Plan. The EU Commission has also issued recommendations on management remuneration focusing on shareholder participation in the approval of remuneration.[184]

The Shareholder Rights Directive, in particular, seeks to facilitate the participation of shareholders in corporate decision-making in publicly listed companies, particularly in the context of shareholder meetings. The directive restricts requirements on share lock-ins and seeks to facilitate cross-border voting, for example. The directive imposes requirements regarding the information that must be provided in advance of shareholder meetings[185] and participation and voting by proxy or by electronic means.[186]

Nordic countries have generally adopted measures to implement minority protection mechanisms regardless of EU regulation. Implementation of some of the EU level initiatives has nevertheless required specific new regulatory measures. The EU agenda emphasizing shareholder rights has also provided clear guidance on the national level for increasing minority protection mechanisms.

[177] First Council Directive of 9 March 1968 on Coordination of Safeguards, Which, for the Protection of the Interests of members and Others, is Required by Member States of Companies Within the Meaning of the Second Paragraph of Article 58 of the Treaty, With a View to Making Such Safeguards Equivalent Throughout the Community (EEC) 68/151, OJ 1968, L 65/8.

[178] Second Council Directive of 13 December 1976 on Coordination of Safeguards, Which, for the Protection of the Interests of members and Others, is Required by Member States of Companies Within the Meaning of the Second Paragraph of Article 58 of the Treaty, With Respect to the Formation of Public Limited Liability Companies and the Maintenance and Alteration of Their Capital, With a View to Making Such Safeguards Equivalent (EEC) 77/91, OJ 1977, L 26/1.

[179] Fourth Council Directive of 25 July 1978 Based on Article 54(3)(g) of the Treaty on the Annual Accounts of Certain Types of Companies (EEC 78/660, OJ 1978, L 222/11) and Seventh Council Directive of 13 June 1983 Based on Article 54(3)(g) of the Treaty on Consolidated Accounts (EEC 83/349, OJ 1983, L 193).

[180] Eighth Council Directive of 10 April 1984 Based on Article 54(3)(g) of the Treaty on the Approval of Persons Responsible for Carrying Out the Statutory Audits of Accounting Documents (EEC) 84/253, OJ 1984, L 126.

[181] Directive 2005/56/EC of 26 October 2005 on Cross-border Mergers of Limited Liability Companies, OJ 2005, L 310; *see also* the Third Council Directive of 9 October 1978 Based on Article 54(3)(g) of the Treaty Concerning Mergers of Public Limited Liability Companies (EEC) 78/855, OJ 1978, L295.

[182] The Takeover Directive, *supra* note 23.

[183] Directive 2007/36/EC on the Exercise of Certain Rights of Shareholders in Listed Companies, OJ 2007, L 184.

[184] Recommendation 2009/384 EC and Recommendation 2009/385/EC.

[185] Shareholder Rights Directive, Art. 5.

[186] Shareholder Rights Directive, Art.7-12.

5. A Summary of Changes in Nordic Corporate Governance

Corporate governance in the Nordic countries has certainly evolved during the past decade. Corporate governance codes, for example, have introduced a new focus on corporate governance procedures. The roles and authority of different corporate organs have been clarified and transparency has been increased. In Sweden, the corporate governance reforms of the past two decades have been the consequence, in part, of perceived corporate scandals which have raised the political salience of corporate governance and increased pressure for more restrictive legislation.[187] The business community has sought to avoid such intervention by dealing with matters through self-regulation in the form of corporate governance and takeover codes.

On balance, the role of boards of directors may have increased along with these developments. Due to the adoption of formal procedures, even large shareholders must increasingly interact with the company through the set corporate governance framework. While boards are still accountable to controlling shareholders, independence requirements have increased board integrity and accountability to all other shareholders as well. As was earlier discussed, the role of management is relatively weak in Nordic corporate governance. CEOs and management remain strictly accountable to boards and large shareholders, and they have not been able to insulate themselves from scrutiny in this regard.

Shareholder rights and minority protection have also been a particular focus area in corporate governance. Based mainly on EU requirements, transparency has increased with regard to corporate matters, and the participation of shareholders in corporate decision-making has been facilitated to some extent. Management compensation and related party transactions, for example, are subject to annual disclosure requirements. Transactions with large shareholders are not subject to approval by shareholders or independent directors.

The influence of labor on corporate governance has clearly decreased in recent decades, reflecting shifts in industrial structures and the political economy. In many cases labor cooperation is limited primarily to informing employees of corporate developments rather than any level of real consultation or negotiation. As was earlier mentioned, however, international product market competition has changed labor priorities with respect to corporate governance.

Despite developments in the political economy, no serious challenges have emerged to the authority of controlling shareholders. Large shareholders are still largely able to dominate corporate decision-making. As control enhancing mechanisms are generally accepted, it also remains cost-efficient to retain corporate control.

IV. Change of Control in the Nordic Countries

The study now turns to discussing the Nordic model of corporate governance in the context of takeovers. This section first discusses the potential for the transfer of wealth among corporate constituencies in control transactions and the characteristics of takeovers in this regard. The section then turns to takeovers in the context of concentrated ownership and certain characteristics of takeovers in the Nordic countries. The section ends with an assessment of the political aspects of takeover regulation in the Nordics.

[187] Habbard (2008), *supra* note 66, at 20.

A. CHANGE OF CONTROL: AN INTRODUCTION

Corporations must be able to respond effectively to changes in the market environment and to change and refocus their business in order to remain competitive.[188] The best available organizational structure for a specific economic activity may vary from period to period. For example, a particular period may be more conducive than another to the reorganization of corporate assets to produce some other product or service or indeed to combining of the assets of one corporation in some manner with those of another corporation. Changes in the business of a corporation can occur through internal or external reorganization.[189] Changes can occur, then, while retaining the same corporate form or through a change of that form.

Gilson points out that one of the only constants regarding corporate enterprise is that the corporate environment will be subject to further changes.[190] Thus, the goal of corporate governance regulation should be to facilitate corporations' adaptation to new circumstances. In Sweden, Söderström et. al. state that "[s]ince the conditions of economic activity are constantly changing the system must also be able to guarantee that control is transferred from less suitable owners to people who are better fitted to take on the ownership role."[191] Thus, corporate governance solutions should support the responsiveness of corporations to changes in their market environment and to technological development.[192] The organizational form of business should be allowed to evolve and change as freely as possible to the extent that it is of benefit to the enterprise. In this context, the continuity of a particular corporation, as such, should not be important. In the same way, it should not generally matter whether a structural reorganization is executed as a divestment, a joint venture, a merger or a tender offer.

Transaction costs will affect the way in which firms or corporations reorganize.[193] Moreover, it is possible for the interests of corporate constituencies to be affected in different ways depending on how change is executed, as organizational changes can and will have re-allocative effects. To the extent that an organizational change is value-increasing, it need not benefit different corporate constituencies in a similar manner, and some may even be worse off, as suggested in the Kaldor-Hicks model of efficiency.[194] The choice of mechanism whereby corporations reorganize will also have an effect on wealth transfers among relevant constituencies. So acquisitions executed as asset transfers, for example, may have different effects on the respective interests of corporate constituencies than acquisitions effected through statutory mergers (where available), which again can provide a different outcome than public tender offers.

These factors have a significant effect on corporate governance regulation, as different constituencies seek to affect regulation to further and protect their own interests. The corporation

---

188 Ronald Gilson, *The Political Ecology of Takeovers: Thoughts On Harmonizing the European Corporate Governance Environment*, 61 FORDHAM L. REV. 161, 174-175 (1992).
189 *See* Ronald Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937); RONALD COASE, THE FIRM, THE MARKET AND THE LAW (1988).
190 Gilson (1992), *supra* note 188.
191 Söderström et al. (2003), *supra* note 49, at 21.
192 Gilson (1992), *supra* note 188.
193 *See* Coase (1937), *supra* note 189; *see also* Oliver E. Williamson, *Corporate Finance and Corporate Governance*, 43 J. OF FIN. 567 (1988).
194 RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 14-17 (1998).

as a specific organizational form of business is formed and affected by the relevant institutional and political framework. The structure of firms, and how they are governed, also involves political considerations. Corporate governance has (re)distributive implications and thus strong political aspects that cannot be overlooked. As discussed, corporate law and corporate governance regulation can be expected to reflect the institutional power of dominant corporate constituencies.[195] Changes in regulation can be seen to reflect changes in the relative bargaining power of these constituencies.

B. Dynamics of Takeovers and Takeover Regulation

1. Corporate Constituencies in Takeovers

As takeovers can have a significant effect on corporate constituencies, it is likely that the interests of politically dominant constituencies are reflected in takeover regulation. Moreover, changes to regulation can reflect the shifting bargaining power of these constituencies. For example, employees may be laid off, or the management changed as a result of an organizational change. Alternatively, shareholders may be worse off as a result of an organizational change that benefits corporate management. Control transactions, as end-game situations, increase the possibility of opportunistic behavior. In the context of dispersed ownership, management is often suspected of "empire building" when planning acquisitions, increasing the size of the firm for their own benefit beyond what is in the best interest of shareholders or other constituencies.[196] On the other hand, in the context of concentrated ownership, controlling shareholders may seek to extract control premiums unavailable to other shareholders.[197] Changes can be, and often are, affected by the self-interest of dominant constituencies.

Management and labor can generally be expected to favor regulation that does not facilitate takeovers. Both constituencies would prefer to avoid change of control without their cooperation. Maintaining acquired privileges and rents is a key driver in this regard. Controlling shareholders may favor regulation facilitating change of control without the participation of other corporate constituencies, but they will look to ensure that their controlling position cannot be challenged without their cooperation. Minority shareholders are more likely to prefer regulation that facilitates change of control despite the possible resistance of other corporate constituencies provided, however, that the offer price is sufficiently high. Minority shareholders are typically constrained in their ability to coordinate their activities and may be pressured to accept even sub-premium bids to avoid being locked into a company with low liquidity if other shareholders accept the bid. Minority shareholders thus need insurance that the price in a tender offer is the best available.

2. Takeovers and Concentrated Ownership

Takeovers have a considerably different dynamic and corporate governance function depending on the structure of corporate ownership. In companies with dispersed ownership, the possibility

---

[195] Armour, Hansmann & Kraakman, *supra* note 109, at 32.
[196] Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3. J. FIN. ECON. 305, 308 (1976).
[197] See Lucian A. Bebchuk, *A Rent Protection Theory of Corporate Ownership and Control* (NBER Working Paper 7203, 1999), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=168990.

of takeovers serves as an external corporate governance mechanism that monitors management performance.[198] In companies with concentrated ownership, however, change of control is typically subject to the cooperation of the controlling shareholder. In fact, concentrated ownership has been seen as a substitute for “the market for corporate control” as a corporate governance monitoring mechanism.[199]

Takeovers in the context of concentrated ownership are really not to be compared with takeovers of companies with dispersed ownership. In an environment of concentrated ownership, takeovers typically result in a transfer of control from one controlling shareholder to another. This type of transaction raises the potential for a different type of agency problem than would otherwise be the case. Basically, a controlling shareholder may seek to obtain a control premium unavailable to other shareholders.

Takeover regulation should also have a different function in the context of concentrated ownership. Regulation may be important for the protection of minority shareholders from abusive behavior by the controlling shareholder. Regulation would then be expected to restrict the extraction of private benefits of control in the form of unwarranted control premiums, or the attempt to redeem minority shareholders on unfair terms.[200] Regulation should also address the possibility of a controlling shareholder preferring not to transfer control even when they were no longer performing an effective monitoring function (“shirking”).

Takeovers can also affect the interests of other corporate constituencies directly or indirectly. It has been suggested that the premium obtained by the selling shareholders is to some extent extracted from other corporate constituencies. For example, there is often concern that employee interests are negatively affected by takeovers, as the buyer typically seeks to reclaim any premiums paid in connection with the acquisition and to make the acquisition more profitable. It has been argued that takeovers allow a breach or renegotiation of implicit agreements or compromises between owners and labor based on the premise of long-term cooperation. With the change of control, the new ownership might seek to breach these understandings and decrease employee benefits. For example, in takeovers, defined-benefit pension funds have been terminated after control has changed.[201] However, it seems that the savings from such measures only correspond to a small portion of the premiums paid in takeovers, and, in fact, wealth transfers from employees to shareholders do not seem to be a significant source of takeover gains.[202] Furthermore, Gilson emphasizes that implicit arrangements can be expected to represent solutions that are mutually beneficial to shareholders and employees in a given institutional environment.[203] Thus, there should be no reason for the acquirer to change efficient

[198] *See* Marc Goergen, Marina Martynova & Luc Renneboog, *Corporate Governance Convergence: Evidence from Takeover Regulation* 6 (ECGI working paper No. 33, 2005), *available at* http://ssrn.com/abstract=709 .
[199] *See* Becht, Bolton & Röell (2002), *supra* note 22.
[200] Paul Davies & Klaus Hopt, *Control Transactions*, in Kraakman et. al (2009*), supra* note 11, at 257.
[201] *See* Jeffrey Pontiff, Andrei Schleifer & Michael S. Weisbach, *Reversions of Excess Pension Assets After Takeovers*, 21 RAND J. OF ECONOMICS 600 (1990).
[202] Gilson (1992), *supra* note 188, at 191.
[203] *Id.*

arrangements.[204] In conclusion, takeovers should not generally be seen to present an opportunity for disenfranchising labor interests.

The main problem in an environment of concentrated ownership is that shirking by the controlling shareholder prevents takeovers from occurring. A large shareholder may choose to reject a change of control even where the shareholder is no longer performing an efficient monitoring function. The shareholder may, in fact, be enjoying non-pecuniary private benefits of control (political influence or esteem, for example), which cannot easily be compensated for in monetary terms. Alternatively, the favored position of controlling shareholders as a result of tax rules and the ease and cost-efficiency of maintaining control decrease his or her non-diversification costs to such an extent that a sale of the control position is unwarranted despite lower returns from the business.

Even if the institutional environment favors block-holding, it is important for there to be mechanisms that facilitate change of control and allow new controlling shareholders to take over when the old ownership is no longer effective.

3. Dynamics in National and EU Level Regulation

Regulation can generally be deemed to reflect the interests of dominant interest groups or political coalitions. With respect to corporate governance and investor protection in general, corporate insiders, entrepreneurs and institutional investors have been identified as the relevant interest groups that can affect regulation, while outside investors have been deemed too fragmented to form an effective coordinated group for the purposes of affecting regulation.[205] Bebchuk & Neeman argue that corporate insiders can capture the full benefits of any changes to regulation, and as they can, to some extent, use corporate funds to affect such changes, they are willing to invest fully in lobbying activity. At the same time, institutional investors are only able to enjoy part of such benefits, as any benefits they obtain will also benefit other investors.[206] It is claimed that entrepreneurs opt for investor protection that is biased toward supporting raising capital. This imbalance is deemed likely to tilt corporate governance regulation – including takeover regulation – to the benefit of corporate insiders and entrepreneurs.[207]

With respect to takeovers, it is argued that target company interests are likely to influence national regulation more than the interests of bidders, while at the international level, target companies may have less influence over regulatory outcomes.[208] Roberta Romano has studied the implementation of state-level takeover regulation in the United States where interest groups representing management, organized labor and community groups advocated for rules increasing the threshold for takeovers.[209] Where legislatures could be convinced that takeovers would result in headquarters, jobs and services moving out of state, anti-takeover rules were not difficult to

[204] *Id.*
[205] *See* Lucian A. Bebchuk & Zvika Neeman, *Investor Protection and Interest Group Politics* (John M. Olin Center Program on Corporate Governance Discussion Paper 603, 2007), *available at* http://ssrn.com/abstract=1030355.
[206] *Id.* at 3-7.
[207] *Id.*
[208] *See* Guido Ferrarini & Geoffrey P. Miller, *A Simple Theory of Takeover Regulation in the United States and Europe* 15 (*New York University Law and Economics Working Paper* 197, 2009), *available at* http://lsr.nellco.org/nyu_lewp/197.
[209] *See* Roberta Romano, *The Political Economy of Takeover Statutes*, 112 VIRGINIA L.R. 111 (1987).

introduce. Similarly, in Europe, it has been argued that national level regulation is likely to favor interest groups with a strong domestic lobbying position. Ferrarini & Miller argue that the interests of corporate insiders remain strong at the national level. As takeovers will be subject to local regulation, they may be able to lobby for anti-takeover rules that protect their interests. At the international level, corporate insiders may not have the same relative advantage over the interests of bidders (and minority shareholders), who may be better able to organize themselves on an international basis.

In line with the above, national takeover regulation in the Nordic countries can be expected to favor large shareholders and labor interests by not favoring hostile takeovers and exhibiting takeover rules that do not challenge the control or decision-making rights of controlling shareholders with respect to takeover situations, while protecting labor interests by general employment legislation.

The EU framework nevertheless creates a parallel regulatory framework to national regulation. Consequently, constituencies are not limited to national regulation but can also pursue agendas through the EU regulatory framework.[210] Callaghan observes that the EU contributes to the development of a multilevel governance framework – also with respect to corporate governance regulation. Callaghan argues that this creates new strategic opportunities for interest groups[211] and that the EU institutional set-up allows for competing political coalitions to simultaneously advance different reforms, thus limiting the possibility for interest groups to monopolize policy.

In an EU context, it is also possible that the benefits of cross-border takeovers are not evenly distributed. Market actors in jurisdictions with a favorable institutional environment may have an advantage over actors in other jurisdictions. When markets are opened through EU regulation, some will be better positioned than others to take advantage of the new situation. For example, bidders in markets with efficient and liquid financial markets can be expected to have better access to the financing needed for large acquisitions than similar actors in other jurisdictions. The optionality allowed in the Takeover Directive also skews the playing field, in that the ability of boards to take defensive action can vary based on the implementation of the relevant provision of the directive.

The EU Takeover Directive

The introduction of the Takeover Directive was highly relevant to corporate governance. The adoption of the directive was very controversial, requiring a legislative process lasting almost two decades. Certain elements of the directive were deemed incompatible with the system of concentrated ownership, supported by control enhancing mechanisms. that dominated key markets. From a Nordic perspective the proposed "break-through" rule limiting the effect of dual share classes was strongly resisted for these reasons.[212] The break-through rule would have deeply affected the Nordic model of corporate ownership and corporate governance with its emphasis on the position of large shareholders. In the context of takeovers, controlling

[210] *See* Helen Callaghan, *How Multilevel Governance Affects the Clash of Capitalisms* (MPIfG Discussion Paper 08/5), *available at* www.mpifg.de (publications, discussion papers).
[211] *Id.* at 10.
[212] *See* Rolf Skog, *The European Union's Proposed Takeover Directive, the "Breakthrough" Rule and the Swedish System of Dual Class Common Stock*, 45 SCANDINAVIAN STUDIES IN LAW 293 (2004).

shareholders would not necessarily have had a veto over takeover bids. Ultimately, it was decided that the implementation of the break-through rule was optional, and few EU member states decided to introduce such a rule in national regulation.

There was also criticism of the mandatory bid rule requiring a shareholder to make a tender offer for all remaining equity securities if his or her holdings exceeded a given threshold (such threshold to be no higher than 50%).[213] The rule was initially controversial in many EU member states, including Sweden. Many interest groups were opposed to the rule, arguing it was inappropriate in an environment with concentrated ownership and would prevent advantageous restructurings and raise the cost of beneficial changes of control. The idea that minority shareholders would have an automatic exit right was also questioned.[214]

4. Recent Development of Nordic Takeover Regulation: Examples

Changes to takeover rules can be expected to reflect changes in the relative bargaining power of corporate constituencies or changes in the interests of politically dominant corporate constituencies or political coalitions. Regulatory changes can take place through legislative processes at the national or international level, but they can also occur through self-regulation. To some extent, self-regulation is used as a mechanism to pre-empt legislative initiatives. Industry participants may seek to avoid legislative intervention by taking regulatory steps to mitigate political concerns, for example. Self-regulation can be a reactionary measure taken when faced with the threat of more intrusive regulation. In this regard, self-regulation can be seen to reflect salient political concerns. Below, the study discusses certain developments relevant to the position of controlling shareholders in takeover regulation (legislation, regulation and self-regulation, as applicable) in the Nordic countries, mainly Sweden and Finland, and considers how these developments reflect the changing political economy and the interests of different corporate constituencies.

Consideration for Different Share Classes

One of the control-enhancing mechanisms used in the Nordic countries is the adoption of different classes of shares with different voting rights, allowing, for example, founding entrepreneurs to raise equity financing without relinquishing control. Founders can retain shares of the super voting class while the company issues shares with a single vote. Through articles of association and minority shareholder provisions in national company law, the controlling shareholder can give a sufficient guarantee to equity investors that their investment will be adequately protected, despite the controlling shareholder maintaining his or her required level of control.

In Sweden there has been much debate over whether to permit payment of a different consideration for different classes of shares in takeovers. Indeed, a good case could be made for paying a different price for shares with superior voting rights. In a change of control context it should be clear that shares with 20 votes, for example, should be worth more than shares with one vote. However, the different share price would, of course, allow a controlling shareholder to

---

[213] *See* Rolf Skog, *Does Sweden Need a Mandatory Bid Rule?, A Critical Analysis* (SUERF Report, 1997), *available at* http://wvw.suerf.org/download/studies/study2.pdf.
[214] *Id.*

be paid a control premium unavailable to other shareholders. In Sweden, takeover rules initially provided that the relative premiums for different share classes should be same even if the price could differ. The takeover rules later provided more latitude for how the value of non-listed shares could be evaluated (typically the controlling block), allowing for some control premiums. As the influence of institutional shareholders increased, the price difference was limited through precedents to approximately 10 percent. More recently, new rules have largely eliminated such premiums altogether.[215]

In Finland, on the other hand, differences between the considerations paid for shares of different classes are still allowed. The requirement in Finnish securities law is that the different prices must be "in a fair and just relationship" to each other.[216] Market practice in Finland has also allowed the payment of premiums to holders of super-voting shares.

Cash Mergers

Pursuant to the EU Takeover Directive, national legislation must provide a shareholder with a sufficiently sizeable majority the possibility of redeeming the shares of minority shareholders. In the Nordic countries the thresholds for the "squeeze-out" right have been set at 90 percent of the shares and votes of the target company.

Due to the lack of deal security caused by the high threshold, there has often been interest in different means of completing acquisitions at lower levels of shareholding. A statutory merger, for example, allows a shareholder to integrate the target company and its assets at lower levels of shareholding, typically two thirds of shares and votes represented at a general meeting of shareholders. However, in mergers the shareholders of the company being merged are usually entitled to shares in the receiving company. In cases where the bidder is a much larger company than the target, a statutory merger may nevertheless allow the acquisition of the target without changing the balance of control in the acquiring company through dilution of the holdings of the minority shareholders. However, it is also possible to pay the consideration in a statutory merger in cash. This would allow the bidder to acquire the target without entitling minority shareholders to shares in the bidder.

There has been some debate on whether such a cash merger would fulfil the criteria of equal treatment of shareholders under the national company laws in the Nordic countries. Traditionally, in Finland and Sweden cash consideration in statutory mergers has not been explicitly forbidden in company law. However, it was argued that cash consideration might still contravene equal treatment rules depending on the specific circumstances in each case. Where the intention was to disenfranchise the minority shareholders, cash consideration could be against company law, but

---

[215] *See* Göran Nyström & Erik Sjöman, *Den svenska takeover-regleringen – ett samspel mellan regelmakaren och Aktiemarknadsnämnden* [Swedish Takeover Regulation – Cooperation between the Regulator and the Swedish Securities Council*]*, in *AKTIEMARKNADSNÄMNDEN 25 ÅR – EN ANTOLOGI* [THE SWEDISH SECURITIES COUNCIL 25 YEARS – AN ANTHOLOGY] 99-100 (Aktiemarknadsnämnden [The Swedish Securities Board], 2011).

[216] Hallituksen esitys Eduskunnalle arvopaperimarkkinoita koskevaksi lainsäädännöksi [Government Bill for Securities Legislation] 746/2012, at139, and Hallituksen esitys Eduskunnalle laeiksi arvopaperimarkkinalain, kaupakamarilain ja Rahoitustarkastuksesta annetun lain muuttamisesta [Government Bill for the Amendment of the Securities Act, the Act on the Chamber of Commerce and the Act on the Financial Supervision], 6/2006, at 33.

where there were legitimate business reasons for paying the consideration purely in cash, there may have been no legal obstacles.

In Sweden, specific new regulation was introduced in 2009 prohibiting pure cash-consideration mergers and requiring that at least 50 percent of the consideration be in shares.[217] A previous measure intervening in cash mergers had raised the threshold for approval of such transactions from the normal requirement of two thirds to 90 percent of votes given and shares present. The stated reason for introducing the new rules in the Swedish Companies Act was to increase minority protection.

In Finland, no such rule has been introduced. In fact, the Helsinki Takeover Code explicitly suggests that cash mergers could be possible provided there are special circumstances that support the payment of the merger consideration in cash. While no cash mergers have been executed to date among listed companies or in connection with takeover situations, the legality of such transactions cannot be ruled out.

Mandatory Bids

The Takeover Directive introduced the mandatory bid obligation in EU takeover regulation, granting an exit right to minority shareholders in connection with a transfer of control. Pursuant to the directive, a shareholder who acquires shares "giving him/her control" of a listed target company is obligated to make a public bid to all remaining shareholders.[218] The thresholds of shareholdings triggering the bid obligation can be set in national laws, and in the Nordic countries they have been set at the level of a 30 percent shareholding in the target company. In addition, some countries have a dual threshold, triggering mandatory bid obligations at the 50 percent level as well.

The directive further provides that an "equitable price" shall be offered in the mandatory bid.[219] The price is linked to the highest price paid by the shareholder during a set period prior to the obligation being triggered. One justification for the mandatory bid rule is that a party obtaining control may also be in a position to exploit private benefits of control at the expense of the other shareholders.[220] In this regard, the mandatory bid rule prevents inefficient transactions where the bidder seeks to extract private benefits of control at the cost of the other shareholders rather than

[217] Regeringens proposition 2007/08:155, Skärpta fusionsregler, [Government Bill 2007/08:155, Revised Merger Rules].

[218] The text of the directive is as follows: " Where a natural or legal person, as a result of his/her own acquisition or the acquisition by persons acting in concert with him/her, holds securities of a company as referred to in Article 1(1) which, added to any existing holdings of those securities of his/hers and the holdings of those securities of persons acting in concert with him/her, directly or indirectly give him/her a specified percentage of voting rights in that company, giving him/her control of that company, Member States shall ensure that such a person is required to make a bid as a means of protecting the minority shareholders of that company. Such a bid shall be addressed at the earliest opportunity to all the holders of those securities for all their holdings at the equitable price as defined in paragraph 4."

[219] The text of the directive isas follows: "The highest price paid for the same securities by the offeror, or by persons acting in concert with him/her, over a period, to be determined by Member States, of not less than six months and not more than 12 before the bid referred to in paragraph 1 shall be regarded as the equitable price. If, after the bid has been made public and before the offer closes for acceptance, the offeror or any person acting in concert with him/her purchases securities at a price higher than the offer price, the offeror shall increase his/her offer so that it is not less than the highest price paid for the securities so acquired."

[220] Goergen, Martynova & Renneboog (2005), *supra* note 198, at 11.

from increased efficiency or synergies. A controlling party may also be in a position to alter the company's strategy and business in such a way that they no longer reflect the original investment of the other shareholders. In such circumstances it has been deemed appropriate to grant an exit right for minority shareholders. Through the pricing mechanism, the rule also limits the possibility of paying control premiums to controlling shareholders in change of control transactions. However, it has also been claimed that the mandatory bid rule increases the price of takeovers and discourages value-creating transactions.[221]

The Takeover Directive allows for the granting of exemptions from the obligation to launch a mandatory bid pursuant to national regimes. In Sweden, for example, remarkably many exemptions are granted annually.[222] There are usually several criteria for exemptions. Typically, exemptions can be granted where a large shareholder takes measures to address the financial distress of the target company, where control is transferred within the same group or sphere of control or where a large shareholder ends up with shares as a result of a share issuance where other shareholders have not subscribed for their pro rata share, for example. In addition, exemptions can be temporary or they can restrict a further increase of holdings. Additional whitewash procedures may also be required for an exemption to be granted. It could be argued that to the extent that the extraction of private benefits of control has been effectively restricted, minority shareholders may be sufficiently protected and a mandatory bid would be unwarranted. The Swedish exemption regime seems to allow controlling shareholders latitude in reorganizing their holdings, which may well be necessary in a system with concentrated ownership.[223] The fairly liberal regime on exemptions applied in Sweden may represent an appropriate response for tailoring EU-based requirements to the national corporate environment.

In Finland the number of bids and exemptions is far lower than in Sweden. The threshold for mandatory bids was decreased from two thirds of shares in connection with the implementation of the Takeover Directive. Requirements for exemptions were revised in 2013, with the aim of emphasizing the need for whitewash procedures as a prerequisite for exemptions. Interestingly, the regime may be more stringent than in Sweden. On the other hand, concentrated ownership and the need to rearrange group or family holdings have not played as significant a role in the Finnish corporate environment as they have in Sweden, as discussed earlier.

Recent Changes to Takeover Codes

Swedish takeover rules were originally introduced in 1971. The Swedish Takeover Code has been amended from time to time, and material amendments were more recently introduced in 2006 and 2009, for example.[224] In 2006, the code was amended to reflect the implementation of the Takeover Directive. In 2009, the code was amended with the aim of enhancing the position of target shareholders in takeovers. One of the main amendments in 2009 was a change that generally disfavored any price differences between ordinary and super-voting shares.[225] The code was also amended to increase the binding nature of announcements regarding public tender offers

---

221 *Id.*

222 DANIEL STATTIN, TAKEOVER 454-456 (2009).

223 *Id.* at 456.

224 Further minor changes and clarifications have been introduced in 2012.

225 *See* Rolf Skog, *Nya takeover-regler på den svenska aktiemarknaden – bolag på reglerade marknader* [New Takeover Rules on the Swedish Stock Market – Companies on Regulated Markets], NTS 2009:3, 122-130.

and to disfavor any indicative announcements, for example. Requirements regarding the type of conditions acceptable in public tender offers were also tightened. In 2012 further changes to the code, largely of a technical nature, were introduced. However, the code was amended to disfavor break-up fees, even though they were not completely prohibited. Further disclosure requirements were also introduced for bidders.[226] The changes in the Swedish Takeover Code can be seen to reflect the increasing influence of minority shareholders. The rules seek to limit the possibility of favoring large shareholders and introduce stringent requirements on bidders with regard to any action that may influence trading in target shares. However, the rules do not, as such, restrict the influence of controlling shareholders outside the context of takeovers.

A takeover code was introduced in Finland in 2006.[227] It was then amended in 2013, as a result of changes to the Finnish securities laws, with the introduction of a "comply-or-explain" rule to the code. The code was originally intended to provide general guidance on the application of central principles of company and securities laws and promote uniform procedures in takeover situations. Importantly, there been no significant pressure from institutional investors or other minority shareholder interest groups with respect to the code provisions. The code also largely acknowledges the position of controlling shareholders and, for example, recognizes that target boards and bidders alike will need to consult with such shareholders in advance of tender offers being launched.

5. Summary of Nordic Developments in Takeover Regulation

As the discussion above demonstrates, takeover regulation seems to be developing along similar lines to corporate governance regulation in the Nordic countries in general. The main drivers for change with respect to takeover regulation seem to have been the introduction of the Takeover Directive and, in Sweden, the increasingly important position of institutional shareholders, including pension funds. Employee interests seem to have had no significant effect on the development of takeover regulation. Importantly, however, the revised regulation of takeovers does not challenge the position of controlling shareholders. The regulatory framework continues to support concentrated ownership and the rights of large shareholders also with respect to change of control.

Interestingly, in contrast to Sweden, there has been no focus on minority shareholder interests with respect to change of control issues in Finland. This is possibly the result of the different structures of the two countries' pension systems and their respective effect on corporate governance. For example, Ambachtsheer has argued that for historical and structural reasons Finnish institutional investors maintain closer relationships with management and controlling shareholders, resulting in less pressure on corporate governance than in Sweden.[228]

---

[226] *Id.*

[227] The Finland Chamber of Commerce, *Recommendation Regarding the Procedures to be Complied with in Public Takeover Bids*, 2006 and The Securities Markets Association, *The Helsinki Takeover Code*, 2013.

[228] Ambachtsheer (2013), *supra* note 163, at 46.

V. Developing Corporate Governance and the Political Economy

This study seeks to identify the regulatory implications of a political economy approach to corporate governance and takeover regulation in the Nordics. Thus far, an explanation of the evolution of regulation has been presented and the case made that the political aspects of regulation must be appropriately recognized. Based on the discussion above, this study now turns to consider the relationship, in the context of Nordic takeover regulation, between regulatory development, on the one hand, and shifting political economy on the other and to identify appropriate regulatory strategies for this environment.

We have seen that corporate governance regulation has evolved in the Nordics in response to changes caused by the internationalization of markets, the increase of equity financing and the increasing equity positions of politically important constituencies. With this development, minority protection has increased, as can be expected. Nevertheless, the basic premises of corporate control have not changed to the same extent. Concentrated ownership and control enhancing mechanisms remain important elements in the corporate environment. While an increase in minority protection mechanisms that do not challenge current control structures are acceptable to incumbent owners, any initiatives that would affect control are likely to be strongly resisted. This dynamic should result in low levels of private benefits of control, increased transparency, sophisticated formal corporate governance rules, the maintenance of control enhancing mechanisms and favorable treatment of concentrated ownership.

The development of corporate governance and takeover regulation in the Nordics provides certain insights into the dynamics of regulatory change. It seems that when considering the development of regulation in this framework, there are at least three factors that should be taken into account. First, the political economy and the institutional environment define the terms on which corporate ownership and control are organized and change of control can occur. Changes in the political economy and the interests of specific corporate constituencies over time can affect the dynamic of corporate governance and allow for regulatory change as well. Second, the development of corporate ownership structures and corporate governance is path dependent and prone to entrenchment. A given structure is often reinforced as complimentary institutions develop and may remain entrenched even as the political economy evolves. The existing institutional framework may therefore support the corporate structures of yesterday. The third aspect to consider is how different constituencies are positioned to promote their interests. For example, the capacity of different constituencies to overcome coordination costs and organize themselves will affect their ability to effectively promote their interests through the political system.[229]

This section briefly discusses these three elements affecting regulatory change, before concluding with a discussion of regulatory strategies based on these elements.

A. The Political Economy of Corporate Ownership and Control

As such, concentrated ownership and control enhancing mechanisms are not necessarily detrimental to firm performance or value. Empirical studies of listed companies in the EU have

[229] *See* Olson (1971), *supra* note 29.

supported the view that concentrated ownership can benefit corporate performance through the monitoring function performed by a large undiversified shareholder, and that concentrated ownership or the use of control enhancing mechanisms need not be related to the extraction of private benefits of control. It seems that the preferences and courses of action pursued by different types of controlling shareholders can be more important factors in this regard.

As has been discussed above, the structure of corporate ownership is a result both of specific historical and industrial development and of the broader institutional environment. Governance models evolve and are tailored to dealing with corporate governance problems in a given institutional environment. Where banks might provide a monitoring function in one type of economy, blockholders will perform similar functions in others, and specific governance models evolve to support this.[230] It can be argued that as a governance model the "blockholder-system" has been demonstrably successful, and as such can provide a competitive alternative to dispersed ownership.

When a controlling shareholder seeks to transfer control and where private benefits of control are restricted, there should no reason for concern from the perspective of minority shareholders. If the acquirer is unable to extract private benefits of control he or she must justify any premiums paid by synergies or by increasing the profitability of the business, which should benefit all shareholders.

Even if the political economy has increasingly come to favor minority protection with respect to corporate governance in general, the position of large shareholders remains unchallenged. The corporate environment in the Nordic countries can still be seen to facilitate concentrated ownership. While direct private benefits of control are low, there can be other benefits for controlling shareholders. It has been argued that due to tax rules and the use of control-enhancing mechanisms, maintaining corporate control is relatively cost efficient. The problem with concentrated ownership is that incumbent owners have a veto over change of control transactions. It is difficult to challenge the existing ownership structure even when it has become sub-optimal or no longer performs value-adding management monitoring functions. In this respect, it may be important to focus on mechanisms whereby change of control can be induced in these types of situations.

B. PATH DEPENDENCE AND CORPORATE OWNERSHIP

The structure of corporate ownership and control is strongly affected by historical and industrial development. As economic enterprise evolves, the nature of production processes will affect the structure and size of the organizational institutions used to manage such enterprise, including corporate governance. The business organization suited to large-scale industrial manufacturing will differ from the organization used for building precision instruments. Corporate finance and corporate governance solutions in such industries may also be different.

It is important to recognize that historical development is path dependent. Once a given structure of ownership has been established, it is likely to be reinforced as complementary institutions

[230] *See* Ronald Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329 (2001).

develop.[231] As discussed by Bebchuk & Roe,[232] the sunk costs, externalities and complementarities caused by initial choices of ownership structure increase the cost of choosing alternative structures.[233] Existing structures may also persist as a result of rent-seeking by incumbents with sufficient (and increasing) bargaining power.[234] The regulatory framework can be seen as a complementary institution that recognizes and reinforces certain ownership structures due to both efficiency and rent-seeking.

Differences in how corporations are controlled are also reflected in the legal powers of different corporate constituencies. This, in turn, can contribute to the way ownership structure develops, as was suggested by a study on the differences between the allocation of legal powers in jurisdictions with different types of corporate ownership.[235] To the extent that the allocation of legal powers favors directors, for example, it leaves limited possibilities for shareholders to affect corporate matters. As a consequence, when incumbent shareholders (or management) raise further equity financing, corporate control can be maintained even without a majority of shares, provided they have ensured representation on the board of directors. Moreover, there is little incentive for outside investors to buy larger stakes in the company considering the limited power they can acquire.[236] On the other hand, in models where the allocation of legal powers favors shareholders, the "original controllers" must ensure they have sufficient voting rights by maintaining a sufficient majority of shareholdings or by making use of control-enhancing mechanisms.[237] It is important to note that in either case control remains entrenched. In the context of dispersed ownership, this should result in "strong managers and weak owners,"[238] while the opposite should occur in countries with a predominance of concentrated ownership.

In fact, it has been demonstrated that the ownership structures prevalent in a given economy may not be the most efficient structures for the circumstances. For instance, Grant & Kirchmaier have studied whether companies with superior performance also represented the dominant structure of ownership in a given economy and found that dominant ownership structures did not seem to be consistent with value maximization principles.[239] Grant & Kirchmaier claim that "current European ownership structures are a function of the complex interaction of historic national regulation, tax codes, strength of institutional investors and individual/family wealth preferences, constraints and psychology. The balancing of these interests through the political process at country level has been a prime determinant of current corporate structures." Thus, according to the authors, existing structures of corporate ownership, or corporate governance, are the outcome of various factors in a given political economy and may not be the most efficient.

[231] *See* North (1990), *supra* note 12.
[232] *See* Bebchuk & Roe (1999), *supra* note 33.
[233] *Id.*
[234] *Id.*
[235] Sofie Cools, *The Real Difference in Corporate Law between the United States and Continental Europe: Distribution of Powers*, 64 (Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series, Paper 490, 2004) *available at* http://lsr.nellco.org/harvard_olin/490.
[236] As a significant portion of the largest US corporations are domiciled in Delaware, the laws of this jurisdiction are used to represent the prevalent position in the United States.
[237] Cools (2004), *supra* note 235, at 64.
[238] *See* MARK J. ROE, STRONG MANAGERS,WEAK OWNERS, THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1996).
[239] Jeremy Grant & Thomas Kirchmaier: *Who Governs? Corporate Ownership and Control Structures in Europe*, (SSRN Working Paper, June 7, 2004), *available at* http://ssrn.com/abstract=555877.

While concentrated ownership may provide a competitive form of corporate ownership and an effective basis for corporate governance, it is important that control can be changed when incumbent owners are no longer effective. However, there has been much concern that the institutional environment in the Nordic countries fails to allow new potential owners to challenge incumbent controlling shareholders even when they no longer provide an effective monitoring function.[240] The main concern of regulation under these circumstances should be to address entrenchment of control.[241] Regulation should not be designed to challenge existing structures of ownership or governance mechanisms, but instead to seek to effect a transfer of control by appropriate means when the current ownership situation is no longer efficient. Regulation could provide appropriate incentives for transferring control or, at the minimum, should not provide deterrents to such transfers. The question is what legal strategies are best suited to these purposes in the relevant institutional environment and in light of the dynamics of legislative processes.

The recent debate on corporate governance in the EU and the Nordic countries also relates to the "varieties of capitalism" debate regarding different types of corporate governance systems.[242] It is argued that economies can enhance their competitiveness by specialization, i.e., by taking advantage of the relative benefits that each type of economy has. This argument suggests that the characteristics of an economy may be accentuated as institutions develop to complement the system in question. This "varieties of capitalism" argument seems to assume that the basis and competitiveness of a particular "variety" is stable and sustainable. Nonetheless, as a result of globalization and technological innovations, the basis for an economic model may change, leading to the need for different models of governance in order to preserve competitiveness. The question is whether the "varieties of capitalism" debate can in fact be defined more accurately in terms of path dependence, where a given "variety" reflects a particular point in the specific development path of an economy. As economies and political systems develop, complimentary institutions emerge, and a corporate governance system will develop with political coalitions and regulatory and governance mechanisms that reflect the interests of politically dominant groups – i.e. different "varieties of capitalism." Path dependence suggests that the system is likely to be entrenched, and deviation from the path becomes increasingly costly and difficult.

C. COORDINATING POLITICAL ACTION

As described by Mancur Olson, different political constituencies have different requisites for pursuing their interests.[243] Small interest groups with similar interests can be expected to overcome coordination problems and manage their interests in a satisfactory way. In the Nordic corporate governance context, controlling shareholders would be an example of this type of market actor.[244] The study has discussed how the interests of controlling shareholders have been reflected in Nordic corporate governance regulation and how, even as the political economy has

[240] Söderström et al. (2003), *supra* note 49, at 24.
[241] *See* Gilson (2006), *supra* note 7.
[242] See Peter A. Hall & David Soskice, *Introduction, in* VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE (Peter A. Hall & David Soskice eds., 2001).
[243] *See* Olson (1971), *supra* note 29.
[244] *See* Guido Ferrarini & Geoffrey P. Miller, *A Simple Theory of Takeover Regulation in the United States and Europe* 15 (New York University Law and Economics Working Paper 197, 2009), *available at* http://lsr.nellco.org/nyu_lewp/197; Armour, Hansmann & Kraakman in Kraakman et. al. (2009), *supra* note 11, at 52; *see also* Högfeldt (2005), *supra* note 30.

evolved, the basic premises of concentrated ownership remain strongly supported at the national level.

According to Olson, large interests groups with similar interests can be expected to pursue those interests through the political system. Unionized labor, for example, can be expected to use the political system to protect their interests. Even if labor were not a direct participant or co-decision maker in corporate governance, its political power is likely to guarantee that its interests are looked after – within the parameters of the political economy. For example, with respect to corporate governance and change of control, employee rights are unlikely to be immediately affected by a change of control transaction. However, an acquirer can change any implicit contracts or arrangements that may have reflected compromises between owners and employees and that have become inefficient. What can occur, for example, is that production facilities or headquarter functions can be moved abroad, or production processes changed and headcounts decreased. Previously companies were incentivized to grow (largely on a domestic basis), thus protecting employees from such outcomes. With the opening of markets, such incentives became increasingly untenable. Moreover, with the increase of foreign ownership, industrial structures have changed, as have the status and expectations of shareholders. As a result, the status of labor has decreased and the focus of unions has shifted towards supporting solutions that maintain the competitiveness of domestic companies.

Large interest groups with dissimilar interests may have difficulties in overcoming coordination problems or accessing the political system. Minority shareholders have typically been categorized as a group which struggles to overcome coordination problems. Minority shareholders have often been deemed to have too divergent agendas and insufficient financial interests to justify the coordination costs required to organize political cooperation. Thus, minority shareholder interests can easily be trumped by the interests of more politically dominant groups. In some economies where the political economy has developed in such a way that labor favors equity interests, the situation is different. With pension reforms, it has been argued that labor interests are increasingly shifting towards supporting minority protection, thus creating the political momentum to develop related regulation.

Based on Olson's arguments, it might be assumed that institutional investors and other minority shareholders are not in in the best position to coordinate activities at the political level with respect to corporate governance or takeover regulation. The interests of these constituencies, then, may require specific attention from regulators if market-based regulation and investor protection are desired. Labor is still a large constituency, and their interests are likely to be reflected through the political system.

VI. CONCLUSIONS: CORPORATE GOVERNANCE DEBATES AND REGULATORY STRATEGIES

This chapter has been concerned with the dynamics of corporate governance and takeover regulation in the Nordics – mainly in Sweden and Finland. The introduction to the chapter noted the current debate on whether corporate governance regulation has come to favor the short term interests of shareholders at the cost of sustainable development and stakeholder interests. The debate has focused on such issues as shareholder primacy in the context of takeovers.[245] It has

[245] Nachemson-Ekwall (2012), *supra* note 25, at 8-12.

been argued that some recent takeovers may have been based less on synergies or economic efficiency than on creating short term benefits for shareholders at the cost of other constituencies, such as employees or creditors.[246] Another criticism has been that the externalities of corporate action, such as loss of jobs or environmental emissions, are not carried by those immediately profiting from the cash flows produced by the corporation but by society at large.[247]

This chapter has argued that a political approach to corporate governance can provide the relevant explanations for recent developments in corporate regulation. The study claims that the effects of the coordination of political action, path dependence and changes in the political economy should not be underestimated in explaining corporate governance outcomes. Corporate governance and takeover regulation have largely evolved as a result of the changes in the broader political economy in the Nordic countries discussed in this chapter. At the same time, the institutional framework continues to support concentrated ownership. Finally, the EU has provided a new avenue for coordinating political action that may circumvent the national regulatory dynamic and facilitate regulatory change.

A. Corporate Governance, Shareholders and Stakeholders

Monitoring by a large undiversified shareholder may well be an effective governance mechanism. For dispersed shareholders, it makes less sense to take on the cost of active monitoring; instead, it is more effective for them to liquidate positions where management does not seem to be performing sufficiently well. A dispersed shareholder system may in fact result in the inadequate monitoring of management, especially as management can be expected to take steps to make such monitoring more difficult and entrench their positions. Market-based monitoring mechanisms, such as takeovers, are deemed to be relatively ineffective at the end of the day.[248]

However, a system with controlling shareholders is of course vulnerable to the extraction of private benefits of control by the incumbent shareholder at the cost of minority shareholders. Nonetheless, due to relatively efficient product market competition, there have not been excessive rents available for extraction in the Nordic countries. Moreover, the political system has provided certain benefits for large shareholders, making "stealing" less appealing. Finally, and most importantly, the increase of politically influential institutional investors provides a monitoring mechanism with respect to controlling shareholders. Public pension funds, for example, often hold significant positions in companies with large shareholders. In many cases the positions may not be sufficiently liquid to allow immediate exit in case of unsatisfactory performance. Thus, pension funds are likely to allow the controlling shareholder to maintain control and steer the company, but they will monitor the performance of the controlling shareholders and, will certainly not allow the extraction of private benefits of control. Even though they are financial investors, these funds have a high level of political influence, as they represent labor interests in the form of retirement benefits. Large shareholders in Sweden are well aware, based on their experience of Swedish regulatory history, that regulatory intervention can be swift when corporate abuse occurs. In markets where the risk of political action is not as

[246] *Id.* at 12.
[247] Sjåfjell (2009), *supra* note 24, at 197-198.
[248] *See* Bebchuk (2005), *supra* note 132.

severe, large shareholders are unlikely to be as responsive. It could be argued the differences in corporate governance regulation in Finland vis-a-vis Sweden are an example of this.

Based on the review of the evolution of corporate governance mechanisms in the Nordic region presented in this study, it seems that controlling shareholders are prepared to accept increased transparency and monitoring of their relationship with the company they control. They also seem to be prepared to accept restrictions to the extraction of private benefits of control, as they receive some level of compensation through an overall institutional environment that is beneficial to large shareholders. However, controlling shareholders are unwilling to allow changes to corporate governance that challenge their ability to control the corporations where they hold large stakes. Thus, it is possible that to some extent the institutional environment is still dependent on concentrated ownership.

B. STRATEGIES FOR REGULATORY INTERVENTION

It remains important to recognize that corporate governance also offers mechanisms for providers of finance to ensure a return on their investment.[249] It matters how corporations are structured, how revenue is allocated and how economic activity is incentivized. There is no guarantee that the outcomes of political bargaining or the results of a path dependent development are optimal or efficient, which raises the question of how these concerns might be addressed through regulatory intervention in a political corporate environment. This study argues that in corporate governance regulation it remains important to provide adequate incentives for investors to provide corporate financing while addressing regulatory concerns characteristic to the relevant form of governance. In a system with an emphasis on concentrated ownership, this would entail not challenging the control mechanisms used by large shareholders but, instead, introducing mechanisms to address abuse of the system, i.e. “stealing” or “shirking” by agents. As discussed earlier, levels of private benefits of control remain low in the Nordic region (representing a lack of “stealing”), but it is unclear whether adequate measures have been taken to allow the control of incumbent shareholders to be challenged when they no longer provide an effective monitoring function (i.e. “shirking”).

The entrenchment of controlling shareholders is one of the characteristics of a system dominated by concentrated ownership. As discussed above, it has proved very difficult to introduce regulation that challenges control per se. It might also be counterproductive to do so in a system relying on controlling shareholders for corporate monitoring. It should be noted that in connection with the adoption of certain EU-level corporate governance regulation, including the Takeover Directive, there was significant resistance to initiatives thought to dilute the control rights of controlling shareholders. Incumbent shareholder groups were able to mobilize political support for their position, and regulatory initiatives such as the break-through rule failed (as perhaps it should). At the same time, other corporate governance mechanisms that increase minority protection, such as increased transparency requirements, have been passed. Thus, while incumbent shareholders have been willing to subject their dealings to increased scrutiny, relinquishing control has been a bridge too far. In designing legal strategies, it may be important to recognize the key concerns of important constituencies and structure regulation accordingly.

[249] Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. OF FIN. 737, 737 (1997).

Instead of challenging incumbent shareholder control, regulation might be introduced that provides incentives for control transfers.

National regulatory systems may well be vulnerable to capture, and with respect to corporate governance they may come to favor politically relevant constituencies. Changes in industrial structures or technological innovation can have a profound effect on the bargaining position of different constituencies, as changes in product markets affect corporate constituencies differently.[250] Changes in the political environment can have the same effect. With respect to corporate governance and takeover regulation in EU member states, the EU regulatory framework has provided a new parallel avenue for regulatory change not subject to the same capture or dynamic as national regulation. The EU has introduced new dimensions to corporate governance regulation that can affect the bargaining power of corporate constituencies significantly. Interest groups that are large and organized at the national level can be fragmented at the EU level, and new groups that have been too small to organize at the national level can have sufficient critical mass to overcome coordination problems at the EU level.

The political dynamic of EU level regulation naturally differs from the national regulation of small countries. Constituencies that may be able to promote their interests effectively at the national level may lack the clout to pursue their agendas at the EU level. The institutional structures prevalent in smaller EU economies may be more prone to change than the structures that dominate in economies with more influence in EU decision-making. Consequently, it is no surprise that EU corporate governance regulation is not tailored to facilitate structures adopted in the Nordic countries. However, it is unlikely that EU-level regulation will challenge the key parameters of the Nordic corporate governance system, i.e., control structures and concentrated ownership. Instead, further measures are likely to be introduced to increase transparency and the accountability of large shareholders. In this regard, examples of new regulation could include enhanced regulatory regimes for related party transactions and the introduction of appropriate fiduciary duties for controlling shareholders.

[250] Peter Nobel (2009), *supra* note 107, at 176 – 179.

CHAPTER 4

TOWARDS A NORDIC CORPORATE GOVERNANCE INDEX: METRICS FOR CONCENTRATED OWNERSHIP

In comparative corporate governance research, it has been recognized that the same metrics may not be appropriate for assessing the quality of corporate governance in different institutional environments and different structures of corporate ownership. The analysis of corporate governance mechanisms for concentrated ownership remains important in this regard. For example, it has been argued that the quality of corporate governance models in the Nordic region, with relatively high levels of concentrated ownership but with reportedly low levels of private benefits of control, is not fully reflected in established corporate governance indices.

This chapter identifies corporate governance metrics that are relevant in an environment of concentrated ownership in a Nordic context. The study finds that many of the current corporate governance indices use metrics that are less relevant than assumed in the context of concentrated ownership. More attention should be given to adapting corporate governance mechanisms to the requirements of the relevant corporate environment, and to recognizing functionally equivalent regulatory mechanisms. The study constructs the basis for a corporate governance index reflecting these factors. The chapter argues that a number of relevant mechanisms are, in fact, applied in the Nordic region but these have not been sufficiently recognized in established indices. Nevertheless, further regulation may be warranted to overcome minority coordination problems for better enforcement of minority interests.

I. INTRODUCTION

Different criteria for assessing the quality of corporate governance systems have been developed in comparative corporate governance research.[1] In this context it is recognized that the application of similar metrics to assess the standards of corporate governance in different institutional environments may be inappropriate, and that corporate governance indices must be adapted to the relevant corporate environment.[2] The structure of corporate ownership has been an important factor in this regard. The broader institutional environment, including the

[1] Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *Law and Finance*, 106 J. OF POL. ECON. 1113 (1998) [hereinafter La Porta et al. (1998) or LLSV]; Rafael La Porta, Florencio Lopez-de-Silanes, & Andrei Shleifer, *Corporate Ownership around the World*, 54 J. OF FIN. 471 (1999), Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *Investor Protection and Corporate Governance*, 58 J. OF FIN. ECON. 2 (2000), Katharina Pistor, Martin Raiser & Stanislaw Gelfer, *Law and Finance in Transition Economies*, 8 ECON. OF TRANSITION 325 (2000), Paul Gompers, Joy L. Ishii & Andrew Metrick, *Corporate Governance and Equity Prices* (NBER Working Paper 8449, 2001), *available at* http://www.nber.org/papers/w8449, and Marina Martynova & Luc Renneboog, *A Corporate Governance Index: Convergence and Diversity of National Corporate Governance Regulations* (TILEC Working Paper 12, 2010), *available at* http://ssrn.com/abstract=1557627.

[2] Lucian A. Bebchuk & Assaf Hamdani, *The Elusive Quest for Global Governance Standards* (John M. Olin Center Discussion Paper 633, 2009), *available at* http://www.law.harvard.edu/programs/olin_center/.

development of complementary institutions and the availability of enforcement systems, must also be considered when assessing the relevance of corporate governance mechanisms.

This chapter analyzes certain corporate governance metrics used to assess the quality of corporate governance and identifies variables that are relevant in an environment of concentrated ownership in a Nordic context. The study finds that in the context of concentrated ownership many of the corporate governance mechanisms used in current indices represent less relevant variables than previously assumed. More attention should be given to adapting corporate governance mechanisms to the requirements of the relevant corporate environment and recognizing functionally equivalent mechanisms when assessing the quality of corporate governance. The chapter argues that mechanisms focused on minority cash-flow rights and measures inducing the transfer of control should be given greater emphasis. In addition, the scope of corporate governance regulation must be understood broadly, so as to include not only corporate regulation but tax and securities regulation.

A. Beyond Universal Corporate Governance Indices

With the development of comparative corporate governance research, there has been much interest in developing universal criteria for assessing the standards of corporate governance.[3] The work of La Porta et al.[4] has been crucial in the development of corporate governance indices and has formed the basis for further development and refinement of such indices.[5] These indices, in turn, have had a significant impact on corporate governance research and policy.[6] They have been used as a guide for developing corporate governance mechanisms and in promoting corporate governance regimes in developing countries.[7] Nonetheless, some scholars question whether universal metrics are at all appropriate for assessing the quality of corporate governance systems in very different corporate environments,[8] arguing that the choice of governance system is closely related to the corporate environment and specific circumstances and that uniform metrics are not suited for such assessments. Bebchuk & Hamdani argue that at the very least corporate governance indices must be better adapted to the relevant institutional environment.[9] The effects and functions of corporate governance mechanisms vary depending on the structure of corporate ownership and on the presence of and access to specific legal institutions, for example. Giving corporate governance mechanisms the same weight in indices without considering these factors distorts attempts to compare the quality of corporate governance.[10]

Bebchuk and Hamdani consequently suggest that separate corporate governance indices be developed for systems with dispersed and concentrated ownership.[11] The dynamics of the relationship between key corporate constituencies in companies with concentrated or

---

[3] *See* Convergence and Persistence in Corporate Governance (Jeffrey N. Gordon & Mark J. Roe, eds., 2004).
[4] *See* La Porta et al. (1998); *see also* La Porta, Lopez-de-Silanes, Shleifer & Vishny (2000), *supra* note 1 and Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *The Economic Consequences of Legal Origins*, 46 J. Econ. LIT. 285 (2008).
[5] *See* Pistor, Raiser & Gelfer (2000), *supra* note 1, and Martynova & Renneboog (2010), *supra* note 1.
[6] *See* Holger Spamann, *Law and Finance Revisited* (HLS John M. Olin Cebter Discussion Paper 12, 2008), available at http://ssrn.com/abstract=1095526 *and* Sanjai Bhagat et al., *The Promise and Peril of Corporate Governance Indices*, 108 Colum. L. Rev. 1803 (2008).
[7] Bebchuk & Hamdani (2009), *supra* note 2, at 7-8; *see also* Bhagat et al. (2008), *supra* note 6.
[8] *See* Bhagat et al. (2008), *supra* note 6.
[9] *See* Bebchuk & Hamdani (2009), *supra* note 2.
[10] *Id.* at 3.
[11] *Id.* at 1-2.

dispersed ownership is fundamentally different. Arrangements for enhancing shareholder protection in dispersed ownership may be less relevant or even detrimental in the context of concentrated ownership.[12] Regulation regarding the ability of the board of directors to oppose takeovers, for example, may be of little relevance in the presence of a controlling shareholder with an effective veto on most control transactions. Other corporate governance mechanisms may be called for in the presence of controlling shareholders, who effectively control corporate strategy and the use of corporate assets. The structure of corporate ownership is one element of a broader corporate environment defined by industrial and historical developments, among others. As the institutional environment develops, complementary institutions evolve, resulting in political and legal institutions with different characteristics, which also affect corporate governance systems.

In the Nordic context, a number of features related to the structure of ownership define the corporate governance landscape. The ability of large shareholders to control corporate affairs is a distinctive and complementary feature of the system. Relevant mechanisms in this regard include the availability of control enhancing mechanisms; for instance, dual class shares are common. Shareholder decision rights tend to be robust, and large shareholders can effectively use their powers through the general meeting of shareholders. Minority shareholders, however, may lack an effective voice in the absence of cumulative voting, for example. These features have affected the scores of Nordic countries in some corporate governance indices.[13] However, corporate governance metrics based on the ability to challenge the control of large shareholders may be misguided in this environment. Instead, metrics related to the exit and cash-flow rights of minority shareholders may be more meaningful. Enforcement mechanisms should also be available that reflect the ability of different constituencies to overcome coordination problems. In this respect it is unclear whether a functioning court system is, in itself, sufficient to provide a meaningful avenue for minority protection if the financial interests of dispersed minority investors are limited and the risks related to litigation high. Instead, increased transparency combined with public enforcement may provide an effective enforcement mechanism for minority interests. The availability and quality of Nordic corporate governance mechanisms and related legal institutions should be assessed in this context.

There are convincing arguments for the notion that universal indices are ill-suited to different structures of corporate ownership.[14] This study is concerned with the dynamics of corporate governance in the context of concentrated ownership in the Nordic countries and focuses on identifying governance mechanisms that are relevant in this environment. The study seeks to contribute to the creation of metrics for analyzing the quality of corporate governance in an environment of concentrated ownership for the purposes of comparative corporate governance research.

B. Corporate Governance and the Institutional Environment

Corporate governance and the structure of corporate ownership reflect the development of economic, political, legal and historical conditions.[15] For example, the model of ownership

[12] *Id.* at 3.
[13] La Porta et al (1998), *supra* note 1.
[14] *See* Bebchuk & Hamdani, *supra* note 2.
[15] Randall K. Morck & Lloyd Steier, *The Global History of Corporate in Governance – An Introduction* in A History of Corporate Governance Around the World: Family Business Groups to Professional Managers 517, 518-522 (Randall K. Morck, ed., 2005); *see also* Peter Högfeldt, *The History and Politics of Corporate Ownership in Sweden*, in A History of Corporate Governance Around the World: Family

and governance that has developed in an economy with heavy industry requiring considerable capital outlays and unskilled labor could be expected to differ from the model in an economy based on products and services requiring firm-specific investments of skilled labor. Nevertheless, industrial and historical developments may not support a specific structure of corporate ownership in all cases.[16] For instance, Roe argues that in countries with strong labor institutions there is likely to be more pressure for corporate governance institutions that favor employees and less for institutions that support the interests of shareholders.[17] For example, companies are likely to be encouraged to expand to secure employment even at the cost of profitability and avoid down-sizing and taking disruptive risks.[18] In this environment the institutions needed for dispersed ownership to flourish are not present, whereas a controlling shareholder, on the other hand, would be in a better position, in relative terms, to bargain over surplus and to resist political pressures.[19]

The importance of historical developments and path dependence has been emphasized in the legal literature on corporate governance.[20] Once a given structure has been established, it is likely to be reinforced as complementary institutions develop.[21] With respect to corporate governance, different systems may develop with the same functional effects. For example, depending on the environment, corporate performance can be monitored by an undiversified large shareholder or financial institutions acting as lenders, or it could be performed by market-based mechanisms, such as takeovers or proxy fights.[22] For example, in the context of concentrated ownership, systems might develop to support controlling shareholders' ability to use control. At the same time, however, monitoring mechanisms may develop to address concerns about the relationship between controlling and minority shareholders. Thus, in an environment with controlling shareholders, there should be little need to focus regulation on the ability of shareholders to monitor management; in contrast, there may well be a need for minority protection mechanisms. In other corporate environments, different, but functionally similar, monitoring systems may evolve.

Corporate governance mechanisms should be developed to address concerns related to the relevant environment, but regulation should not undermine the basic premises of the particular governance system. This means that the standard and quality of corporate governance regulation must be analyzed and assessed in the context of the relevant institutional environment, i.e., how well the regulatory framework addresses the vulnerabilities and potential for abuse in that particular system. To be meaningful, corporate governance indices should recognize mechanisms that are complementary to the corporate environment. On the other hand, indices should also identify the problems and potential for abuse associated with the specific system of governance and assess how these are addressed.

BUSINESS GROUPS TO PROFESSIONAL MANAGERS, *supra; and* Paul Davies et al., *Beyond the Anatomy*, in REINIER KRAAKMAN ET AL, THE ANATOMY OF CORPORATE GOVERNANCE 305 (2ND ED., 2009).

[16] *See* Mark Roe, *Political Preconditions to Separating Ownership from Corporate Control*, 53 STAN. L.REV. 539 (2000); *see also* Magnus Henrekson & Ulf Jakobsson, *The Swedish Corporate Governance Model: Convergence, Persistence or Decline?,* 20 CORPORATE GOVERNANCE: AN INTERNATIONAL REVIEW 212 (2012).

[17] Roe (2000), *supra* note 16, at 18.

[18] *Id.* at 18-19.

[19] *Id.* at 19.

[20] *See* Lucian A. Bebchuk and Mark J. Roe, *A Theory of Path Dependence in Corporate Governance and Ownership*, 52 STAN. L. REV. 127 (1999).

[21] *See* DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE (1990).

[22] Marco Becht, Patrick Bolton & Ailsa Röell, *Corporate Governance and Control* 1 (ECGI Finance Working Paper 02/2002), *available at* http://ssrn.com/abstract=343461.

Scholars have observed that the structure of corporate ownership is reflected in how corporations are controlled. This has often been reflected in the allocation of legal powers among corporate constituencies, which in turn has affected the evolution of ownership structures. In jurisdictions with dispersed ownership, management generally has the legal power to control corporate strategy and the use of corporate assets, while in countries where concentrated ownership is prominent, controlling shareholders have the authority and power to do so. The regulatory environment commonly reflects the interests of politically dominant constituencies. It has been noted that "[c]orporate law everywhere clearly reflects the institutional and political power of a country's dominant corporate interests, whether they be banks, prominent families, investment funds, or unions."[23] Nonetheless, at the same time efforts have been made to shape corporate law to "enhance the efficiency with which corporations can be financed and managed in the context of the country's particular pattern of ownership."[24] Consequently, it seems clear that these aspects should be recognized when constructing corporate governance indices. In other words, indices should be constructed to reflect real world political dynamics – without necessarily compromising requirements related to the quality of the governance system.

C. Regulatory Implications – the Goals of the Study

Corporate governance rules should be tailored to the relevant institutional environment based on the suitability of different legal strategies. In different institutional environments, different mechanisms can be functional substitutes, providing relevant and similar governance functions.[25] Where markets for corporate control are deemed to provide a market-based monitoring system in an environment of dispersed ownership, large shareholders or financial institutions[26] are deemed to provide a similar function in other corporate ownership structures. Thus, when the corporate environment differs, so do the relevant corporate governance mechanisms.

Legal intervention in economic activity can take many forms, varying from the enforcement of standards of behavior (such as the fiduciary duties of the board) to empowering economic actors to pursue their rights independently through legal and contractual structures (shareholders' meetings, for example). To be effective, the type of legal intervention may need to be adjusted to the particular circumstances, as discussed. For example, intervention cannot rely on aggrieved parties' pursuing their rights independently if they lack the incentives or means to do so. Another aspect to consider in planning legal intervention and designing regulations is how they will be received by the affected constituencies and whether it is feasible that initiatives will pass the legislative process.

Scholars have outlined a typology of legal strategies in the context of corporate governance, with mechanisms divided into ex ante and ex post regulatory and governance strategies.[27] Ex ante regulatory strategies include rules and ex post regulatory strategies include standards. Further regulatory strategies concern terms of entry and exit,[28] including disclosure obligations and appraisal rights. Governance strategies grant governance rights, such as

[23] John Armour, Henry Hansmann & Reinier Kraakman, *What is Corporate Law?* 1, 32 in Kraakman et al. (2009), *supra* note 15.
[24] *Id.*
[25] *See* Becht, Bolton & Röell (2002), *supra* note 22, at 1 and 31-36.
[26] *Id.* at 1.
[27] John Armour, Henry Hansmann & Reinier Kraakman, *Agency Problems and Legal Strategies*, 35, 39 in Kraakman et al. (2009), *supra* note 15.
[28] *Id.*, referred to as "Affiliation Terms."

appointment rights (election of the board), decision rights and incentive schemes. For instance, decision rights can take the form of the right to initiate or ratify management decisions. Such legal strategies should be tailored to the relevant institutional environment, including the structure of corporate ownership. Importantly, the mechanisms used to address regulatory concerns in the context of dispersed ownership may be ineffective in an environment of concentrated ownership and may, for example, even further entrench corporate control.[29] Moreover, when governance rights are granted to minority shareholders in such an environment, coordination problems are likely to prevent them from making effective use of those rights.

The broader legal and institutional environment is also important for choosing appropriate legal strategies. For example, certain strategies rely on the availability and quality of legal institutions such as courts or supervisory agencies.[30] These institutions are likely to have developed to complement existing structures of corporate ownership and control and may or may not provide an effective basis for enforcement. Ex ante rules require support from regulators who can monitor the markets and respond in a timely manner.[31] More general standards of behavior, on the other hand, require an advanced legal system.[32] For example, in some jurisdictions courts may not be geared to address complex corporate matters in a timely fashion. Moreover, in the absence of class actions, the balance between risks and potential returns may, in effect, provide disincentives to use certain corporate governance mechanisms and hence neutralize minority protection.[33] Dispersed minority shareholders are burdened by coordination problems, and thus mechanisms based on active monitoring, such as standing to sue, may be less relevant than ex ante rules and regulations.[34] The principle of equal treatment of shareholders, for example, is often enforced ex-post by actions initiated by aggrieved parties. As a legal strategy, such tools are problematic with respect to large, diverse interest groups with a high threshold for coordinating their activities.[35] Introducing a regulatory mechanism that is neutralized by the structure of corporate ownership or the lack of effective enforcement mechanisms is futile, as is its use as a metric in a corporate governance index without reference to the institutional environment. Moreover, using uniform metrics in corporate governance indices without taking the relevant structure of ownership into consideration will produce misleading results.

This chapter seeks to identify the key corporate governance metrics for concentrated ownership and apply them in a Nordic context. After introducing the theme and objectives of the study in Section I, the chapter turns to a discussion of the dynamics of corporate governance in the context of concentrated ownership in Section II. The chapter then describes certain corporate governance indices currently in use and analyzes the relevance of their key metrics in an environment of concentrated ownership in Section III. The chapter also introduces a summary of the relevant metrics for concentrated ownership. In Section IV the study assesses Nordic corporate governance mechanisms in light of the summary, before

---

[29] *See* John C. Coates IV, *Ownership, Takeovers and EU Law: How Contestable Should EU Corporations Be?* (ECGI Law Working Paper No. 11/2003), *available at* http://ssrn.com/abstract=424720.
[30] Armour, Hansmann & Kraakman (2009), *supra* note 27, at 40 and 46-47.
[31] *Id.*, at 52.
[32] *Id.*
[33] *See* Roland Gilson, *The Nordic Model in an International Perspective*, in THE NORDIC CORPORATE GOVERNANCE MODEL 94, 103 (Per Lekvall, ed., 2014).
[34] *See* Armour, Hansmann & Kraakman (2009), supra note 27.
[35] *Id.*, at 52.

offering some conclusions in Section V. The basis for a corporate governance index for concentrated ownership is set out in the Annex.

II. CORPORATE GOVERNANCE AND CONCENTRATED OWNERSHIP

Each form of corporate ownership raises its own set of governance challenges that should be addressed in the context of the relevant structure of ownership and the broader institutional environment. This should also be reflected in corporate governance indices. Therefore, understanding the dynamics of corporate governance in the context of concentrated ownership constitutes an important goal of this study. This section discusses the corporate governance issues that arise in the context of concentrated ownership, and the dynamic of corporate governance in that environment. This assessment will then form the basis for evaluating corporate governance indices.

A. INTRODUCTION

Rather than implying inferior corporate performance, concentrated ownership can offer a competitive basis for corporate enterprise.[36] While concentrated ownership has been found to correlate with weaker firm performance in certain regions, [37] a number of studies have found a positive relationship between firm performance and concentrated ownership.[38] A large, undiversified controlling shareholder may have the incentive and the ability to provide more effective monitoring of management than that offered by market-based mechanisms in a dispersed ownership environment.[39] For example, if sufficient restrictions are in place to limit the ability of controlling shareholders to extract private benefits of control through related-party transactions, the structure may well provide for a competitive form of ownership.[40]

The dynamics of corporate governance are fundamentally different in the context of dispersed or concentrated ownership. In companies with concentrated ownership, the relationship between majority and minority shareholders is a central factor in corporate governance. Generally, a controlling shareholder is able to effectively monitor management,[41] and thus there is less concern about the relationship between shareholders and management. On the other hand, there is considerable concern about controlling shareholders' taking advantage of their controlling position to use corporate assets to benefit their own interests rather than those of all shareholders and extracting private benefits unavailable to other shareholders.

Typically, private benefits are extracted in related-party transactions or self-dealing, termed "diversionary private benefits of control"[42] or simply "stealing."[43] However, controlling shareholders can also use their controlling position to steer the company towards the pursuit

[36] *See* Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARVARD L. REV. 1641 (2006).
[37] *See* Claessens, S, Djankov, S., Fan, J.P.H. and Lang, L.H.P., *Disentangling the Incentive and Entrenchment Effects of Large Shareholdings*, 57 J. OF FIN. 2741 (2002).
[38] *See* Torben Pedersen & Steen Thomsen, *Ownership Structure and Value of the Largest European Firms: The Importance of Owner Identity*, 7 J. OF MANAGEMENT AND GOVERNANCE, 27-55 (2003).
[39] *See* Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785 (2003).
[40] Gilson (2006), *supra* note 36, at 1649-1650 and 1678-1679.
[41] *See* Bebchuk & Hamdani (2009), *supra* note 2, at 18.
[42] Alessio M. Pacces, *Control Matters: Law and Economics of Private Benefits of Control* 30 (Rotterdam Institute of Law and Economics, Working Paper 2009/04, 2009), *available at* http://ssrn.com/abstract=1448164.
[43] Mark Roe, *Corporate Law's Limits* 16-17 (Columbia Law School Center for Law and Economic Studies, Working Paper 186, 2002), *available at* http://papers.ssrn.com/abstract=260582.

of goals unaligned with the interests of other shareholders, or they can fail to use their controlling position to monitor management while resisting any transfer of control. These situations are viewed as “distortionary private benefits of control”[44] or simply “shirking.”[45]

In the case of controlling shareholders, it has been argued that while it is possible to restrict diversionary private benefits through regulation, it is more difficult to address shirking.[46] A large controlling shareholder may rationally direct the use of corporate assets for purposes other than the maximization of shareholder value. It is argued that in the presence of control enhancing mechanisms this danger is accentuated, as the relative economic risk of the controlling shareholder decreases in relation to his or her level of control.[47]

However, concentrated ownership can also be seen as stemming from the requirements of the corporate environment. Concentrated ownership can be viewed as the outcome of bargaining among corporate constituencies over the terms and conditions of corporate finance and other firm-specific investments made in the corporate enterprise in a particular institutional environment. This includes a trade-off between the different types of risk profiles and appetites of the different constituencies; i.e., the structure of corporate finance, and the distribution of control and cash flow rights, reflect a trade-off over how the risk profile of the investment is controlled. The purpose of control is not necessarily to extract private benefits but to provide a stable corporate ownership structure in a given institutional environment. The institutional set up may favor, in relative terms, concentrated ownership over other structures of ownership.[48]

It is possible that the controlling constituent prioritizes control rights over cash-flow rights, whereas other investors take the opposite view, allowing the parties to seek an optimal balance in the form of the financial structure of the corporation. Indeed, for minority shareholders, individual investments may represent only part of a portfolio of financial investments. In this context the financial aspects of the investment, including cash-flow rights and the liquidity of the investment, are prioritized over control rights. At the same time, the controlling shareholder holds an illiquid position and seeks to maximize its value through the use of its control rights. In many cases, controlling shareholders need not be opposed to the cash-flow and exit rights of minority shareholders as such, provided that their control rights remain unchallenged.

Instead of being a means of extracting private benefits, corporate control may be an important condition for firm-specific investments in certain circumstances. In fact, corporate control has also been associated with the ability to pursue value maximizing strategies that markets are not fully able to price.[49] For the purposes of corporate governance regulation, it may be just as important to recognize the interests of the controlling constituents (or agents) as to acknowledge the need to protect minority shareholders.[50] Thus, minority protection

---

[44] Pacces (2009), *supra* note 42, at 14.
[45] *See* Roe (2002), *supra* note 43.
[46] *Id.*
[47] *See* Lucian A. Bebchuk, Reinier Kraakman & George Triantis, *Stock Pyramids, Cross-Ownership and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control From Cash-Flow Rights* in CONCENTRATED CORPORATE OWNERSHIP 445 (Randal Morck, ed., 2000).
[48] *See* Enrico C. Perotti & Ernst-Ludwig von Thadden, *The Political Economy of Dominant Investors* (Tinbergen Institute Discussion Paper 2004-091/2), *available at* http://dare.uva.nl/document/5462; *see also* Roe (2000), *supra* note 16.
[49] *See* Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision,* 125 YALE L.J. 560 (2013).
[50] *Id.* at 560.

mechanisms should not undermine the controlling shareholder by challenging his or her decision rights.

Below, this study describes some of the key characteristics of corporate governance in the context of concentrated ownership. The purpose of the study is to establish how corporate governance metrics can be adapted to these characteristics.

B. PRIVATE BENEFITS OF CONTROL

Private benefits of control can be extracted in various ways. For example, in an environment of dispersed ownership, there is concern about management primarily pursuing its own interests over those of shareholders. Managers may look to establish "perks" (i.e., non-market-based remuneration and benefits of office) or strive to pursue interests that diverge from those of other corporate constituencies. Takeover activity, for example, is often seen as "empire building" by management if a clear economic basis is lacking for corporate acquisitions. In concentrated ownership, a controlling shareholder may take a disproportionate share of the company's current earnings through related-party transactions (or "tunneling"), for example. The controlling shareholder may also fail to use its controlling position to effectively monitor management performance while resisting any transfer of control. Controlling shareholders may also attempt to freeze out the minority or may seek to sell their controlling block at a premium unavailable to other shareholders.

These methods of extraction are in all material respects substitutes, and should thus be addressed in corporate governance. Hence, limiting the control premiums of large shareholders in takeovers, for example, makes little sense if controlling shareholders are able to extract private benefits of control through related-party transactions – and vice versa. In contrast, Gilson and Gordon argue that regulation facilitating sale of control may create the potential for greater efficiency gains than favoring freeze outs by controlling shareholders.[51] As long as there are effective limits on the extraction of private benefits of control from ongoing operations, an acquirer of a controlling block will have to increase efficiency to obtain benefits from the transaction – which then come to benefit the minority shareholders as well.[52]

When assessing the quality of corporate governance regimes, it is important to identify whether legal regimes seek to restrict the extraction of private benefits by controlling shareholders through such mechanisms as related-party transactions or tunneling. With the decrease in private benefits (given that their complete elimination is unlikely), controlling shareholders may be less inclined to maintain control in the face of value adding control transactions if they can no longer contribute to the enterprise. As discussed by Gilson and Gordon, it may be less problematic, at the margin, if limited private benefits are obtained in connection with the sale of control.

C. CONCENTRATION OF CORPORATE CONTROL

A central characteristic of concentrated ownership is the ability of a controlling shareholder to control corporate strategy and the use of corporate assets. In the context of concentrated ownership, it is often the case that corporate control is concentrated with the controlling shareholder, with minority shareholders generally having a very limited ability to use shareholder rights to affect corporate control. For example, in many jurisdictions a controlling

[51] *See* Gilson & Gordon (2003), *supra* note 39.
[52] *Id.* at 21-22.

shareholder often has de facto control over the general meeting. There has been concern that a controlling position is open to abuse and that mechanisms restricting controlling shareholders from disenfranchising minority shareholders have been insufficient.[53] Is has also been argued that monitoring agent behavior is more effective in dispersed ownership, where management is accountable to shareholders and market-based mechanisms.[54] Nevertheless, it has also been suggested that corporate control is likely to be concentrated regardless of the structure of ownership,[55] and that this is a key characteristic of corporate governance more generally.[56] Legal systems support management control in jurisdictions with a prevalence of dispersed ownership, while shareholder power may be stronger in jurisdictions with a prevalence of concentrated ownership.[57]

The concentration of control with a controlling shareholder has a significant effect on the dynamics of corporate governance. The main function of shareholder rights in this context is to ensure that the controlling shareholder can effectively monitor management and control the company. In this environment minority shareholders can expect to have little decision-making rights with regard to corporate strategy or the use of corporate assets, and in many respects voting rights at general meetings are apparent only. As the controlling shareholder is likely to dominate decision-making on corporate affairs, corporate governance mechanisms based on voting rights and participation (i.e. "voice") are less relevant. The controlling shareholder provides the monitoring function in this regard. In fact, the ability of a minority shareholder to challenge the corporate power of the incumbent controlling shareholder may result in the former engaging in opportunistic behavior, as a smaller investment is at stake vis-à-vis that of the large shareholder. However, minority protection mechanisms remain an important aspect of corporate governance for the protection of the exit and cash-flow rights of the minority against potential abuse from large shareholders.

D. CONTESTABILITY OF CONTROL

An important task of corporate governance is facilitation of the ability of corporations to adapt to changing business environments. Corporate governance systems, including the structure of corporate ownership and control, may strengthen over time, as complementary institutions develop.[58] As legal systems evolve, the position of the controlling constituents is strengthened in relative terms and even entrenched. At the same time, the nature of the corporate environment is one of pervasive change,[59] and it is vital that the organization of a business enterprise can be efficiently adapted to changing circumstances. As the business environment changes due to technological or market developments, corporations should be able to adapt their organizational structures[60] to the new environment, and this should be facilitated by regulation. Corporate governance and the transfer of corporate control are

---

[53] Becht, Bolton & Röell (2002), *supra* note 22, at 17-21, *see also* Lucian A. Bebchuk, *Efficient and Inefficient Sales of Corporate Control*, 109 Q´LY J. ECON. 957 (1994).
[54] Becht, Bolton & Röell, *supra* note 22, at 12-17.
[55] *See* Martin Hellwig, *On the Economics and Politics of Corporate Finance and Corporate Control* in CORPORATE GOVERNANCE: THEORETICAL AND EMPIRICAL PERSPECTIVES 95 (Xavier Vives, ed., 2000).
[56] *See* Pacces (2009), *supra* note 42, at 9 and 30.
[57] *See* Sofie Cools, *The Real Difference in Corporate Law between the United States and Continental Europe: Distribution of Powers* 64 (Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series, Paper 490, 2004) *available at* http://lsr.nellco.org/harvard_olin/490.
[58] *See* Bebchuk & Roe (1999), *supra* note 20 *and* Cools (2004), *supra* note 57.
[59] Ronald J. Gilson, *The Political Ecology of Takeovers: Thoughts on Harmonization of the European Corporate Governance Environment*, 61 FORDHAM L. REV. 161, 175 (1992).
[60] *Id.* at 170.

important elements in this respect.[61] However, in terms of regulatory responses, the self-reinforcing nature of the structure of corporate ownership and control poses a severe challenge. Consequently, facilitating changes of corporate ownership may, in fact, be as important as attempting to address concerns related to the corporations' existing ownership structure through regulation.[62]

A central characteristic of concentrated ownership is the difficulty in transferring control even where such change could be value-increasing.[63] Ownership structures should vary and evolve according to the market requirements of the day.[64] However, it may not be in controlling shareholders' interest to relinquish control unless they are compensated for potential future private benefits, which creates a disincentive for controlling shareholders to agree to some value-increasing control transfers.[65] Moreover, it has proven difficult to challenge the control of an incumbent controlling shareholder by regulatory means. Control can be exercised on the basis of a variety of governance mechanisms, and controlling shareholders are likely to adapt to any regulatory changes aimed at challenging control rights.[66]

The dynamic of takeovers, for example, is different in companies with dispersed and concentrated ownership. In companies with dispersed ownership, the possibility of a hostile takeover can be used as a market-based mechanism to monitor management performance. As unsatisfactory performance is reflected in the share price, a bidder will be able to offer a premium to shareholders and thus change management. In companies with concentrated ownership, however, the controlling shareholder holds the key to control of the company and has a veto right regarding control transactions. If a controlling shareholder is able to extract private benefits, it will not be in his or her interests to sell the company, even at a premium, unless future private benefits are compensated for. It has also been observed that where a controlling shareholder enjoys purely non-pecuniary private benefits, such as political influence or social standing,[67] it can be even more difficult to compensate the incumbent for the purposes of a control transaction.

To the extent that control cannot readily be contested, other means may be required to induce transfers of control if the current structure has become sub-optimal. The fact that control cannot be challenged does not necessarily mean that control will not be transferred. It has often been pointed out that even though concentrated ownership is predominant in Sweden, the country has traditionally had a high level of takeover activity. Efforts should thus be made to ensure that the independent transfer of control is appealing to controlling shareholders when they can no longer provide an efficient monitoring function and, on the other hand, that maintaining a controlling position in such circumstances is less attractive.

E. CORPORATE GOVERNANCE AND ENFORCEMENT

Several factors must be taken into account when considering appropriate regulatory responses to policy concerns. The problems that arise in the context of corporate governance can be addressed by substantive legal mechanisms that differ in accordance with the characteristics

[61] *Id.* at 164.
[62] *Id.* at 174-175.
[63] *See* Bebchuk (1994), *supra* note 53.
[64] Gilson (2006), *supra* note 36 at 1645.
[65] *See* Bebchuk (1994), *supra* note 53.
[66] Coates (2003), *supra* note 29, at 6.
[67] *See* Jeremy Grant & Thomas Kirchmaier: *Who Governs? Corporate Ownership and Control Structures in Europe*, (SSRN Working Paper, June 7, 2004), *available at* http://ssrn.com/abstract=555877.

of the relevant institutional environment. As described by Mancur Olson, different political constituencies have different requisites for pursuing their interests.[68] To the extent that a small homogenous group has similar interests they are likely to be able to coordinate their efforts to affect political and regulatory outcomes. On the other hand, heterogeneous groups with similar interests have considerable coordination problems and may need protection from regulatory intervention.[69] Similarly, in the context of legal strategies, Kraakman et al. argue that controlling shareholders may be well positioned to pursue governance rights (decision rights etc.) through private enforcement, while the interests of dispersed minority shareholders require protection through regulatory strategies, such as rules and standards, preferably enforced by public authorities.

In jurisdictions where corporate ownership is concentrated and a smaller group can benefit from lower coordination costs, legal institutions are likely to evolve that grant these constituencies authority to exercise and enforce control rights efficiently – ultimately through legal action, if necessary. Minority shareholders are not in a similar position to defend their interests. Where ownership is dispersed, there is more need for rules and standards that protect minority shareholder interests,[70] and they can be enforced by public authorities. Increased transparency, clear regulations and independent agencies are the relevant mechanisms in this environment. In fact, in such jurisdictions the court system may lack the necessary features to pursue matters of this kind. In particular, the assessment of standards that are adjudicated ex post, such as principles of equal treatment and other general principles of company law, may include discretion that does not lend itself to efficient and timely enforcement. In some cases, these issues have been addressed by introducing specialized commercial courts or by allowing class actions suits.

III. CORPORATE GOVERNANCE METRICS FOR CONCENTRATED OWNERSHIP

This section describes certain corporate governance metrics that have been applied to determine the quality of corporate governance systems in connection with concentrated ownership. The key metrics discussed include those identified by La Porta et al. (LLSV), Djankov et al.,[71] Bebchuk, Cohen & Ferrell,[72] Bebchuk & Hamdani,[73] Gompers, Ishii and Metrick,[74] Pistor[75] and Martynova & Renneboog.[76] The metrics will be analyzed to determine their relevance in the context of regulatory concerns related to concentrated ownership that have been discussed in this chapter. Based on this analysis, this section r will then introduce a new summary of measurement variables for assessing corporate governance in the context of concentrated ownership.

A. MEASURING SHAREHOLDER PROTECTION

[68] *See* MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS (1971).
[69] *Id*.
[70] Armour, Hansmann & Kraakman (2009), *supra* note 27, at 52.
[71] *See* Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, *The Law and Economics of Self-Dealing*, 88 J. OF FIN. ECON. 430 (2008).
[72] *See* Lucian A. Bebchuk, Alma Cohen & Allen Ferrell, *What Matters in Corporate Governance?* (HLS John M. Olin Center Discussion Paper 491/2005), *available at* http://papers.ssrn.com/so13/papers.cfm?abstract_id=593423.
[73] *See* Bebchuk & Hamdani (2009), *supra* note 2.
[74] *See* Gompers, Ishii & Metrick (2001), *supra* note 1.
[75] Katharina Pistor, *Patterns of Legal Change: Shareholder and Creditor Rights in Transition Economies*, 1 EBOR 59, 72-79 (2000).
[76] Martynova & Renneboog (2010), *supra* note 1.

The level of shareholder protection has been measured, among others, on the basis of selected legal provisions. The much cited index developed by La Porta et al. identifies the factors believed to be relevant when measuring the level of investor protection in jurisdictions with different types of legal systems. La Porta et al. use these variables to assess investor protection in terms of the relationship between both shareholders and management, and minority and controlling shareholders.[77] These include (i) the requirement that shares are not blocked before general meetings, (ii) the possibility of mailing a proxy vote at general meetings, (iii) the percentage of share capital required to call an extraordinary general meeting, (iv) pre-emptive rights when new shares are issued, (v) cumulative voting (a mechanism whereby the minority may nominate a proportional number of board members) and (vi) protection mechanisms providing oppressed minority shareholders with exit rights or the standing to challenge corporate decisions (such as mergers, changes to articles or asset sales).[78]

The metrics presented by La Porta et al. may reflect factors for overall good corporate governance in that they measure the ease with which shareholders can participate in corporate governance more generally. However, the La Porta et al. index has faced some criticism.[79] For example, the measurement variables fail to recognize the specific characteristics of different corporate governance systems or the possibility of the functional equivalence of different types of corporate governance mechanisms. Independently, voting rights or even standing to sue may be less relevant for minority protection in an environment of concentrated ownership than the appropriate regulation of related-party transactions, for example. Moreover, each of the six metrics is given the same value in the La Porta et al. index, which does not necessarily reflect their relevance relative to one another.

While the La Porta et al. index has been an important benchmark, it has been developed and modified by several scholars.[80] For example, in a study on transition economies, Pistor adds a mandatory one-share-one-vote rule and rules on minimum dividends to the shareholder rights index. Her study also regroups shareholder rights into "Voice," "Exit," "Anti-management," "Anti-block holding" and "Stock market integrity" indices.[81] "Voice" includes mechanisms for shareholders to vote and affect corporate decisions in relation to their holdings (including the LLSV mechanisms). "Exit" includes rules that facilitate the right of shareholders to exit their investment at fair value. An example of an "Exit" rule is the right of minority shareholders opposing major changes (mergers or changes to articles) to require redemption of their shares. "Anti-management" rights and "Anti-block holding" rights are used to assess the relative weight given by a legal system to the conflict between shareholders and management, and between block-holders and minority shareholders, respectively. "Anti-block holding" mechanisms include rules on cumulative voting, quorum rules and rules providing judicial recourse.[82] The "Stock market integrity" index measures mechanisms that protect the integrity of the market as a whole, such as insider rules and the existence of independent

---

[77] La Porta et. al. (1998), *supra* note 1, at 1127.
[78] *Id.* at 1123, 1127-1128.
[79] *See* Bebchuk & Hamdani (2009), *supra* note 2; see also Gilson (2006), *supra* note 36.
[80] *See* Marco Pagano & Paolo Volpin, *The Political Economy of Corporate Governance*, 95 THE AMERICAN EC, REV. 1005 (2005); *see also* Holger Spamann, *The "Antidirector Rights Index" Revisited*, 23 THE REV. OF FIN.STUDIES 467 (2009) *and* Pistor (2000), *supra* note 75.
[81] Pistor (2000), *supra* note 80; *see also* Pistor, Raiser & Gelfer (2000), *supra* note 1.
[82] See Pistor (2000), *supra* note 75, at 95-99.

market regulators. Pistor points out that such mechanisms, which provide market liquidity, can be functional substitutes for other shareholder rights.[83]

Pistor's study was conducted in the context of analyzing legal developments in transition economies.[84] However, her identification of different types of indices and her recognition that there can be functional substitutes for different mechanisms are useful for developing a taxonomy of corporate governance mechanisms. This allows for a choice of mechanisms depending on the dynamics of the institutional environment. In the context of concentrated ownership, for example, granting "Voice" rights to minority shareholders can also allow opportunistic behavior and can be strongly opposed by controlling shareholders. "Exit" rights, on the other hand, could provide a feasible substitute in this environment. Moreover, clearly identifying "Anti-block holding" metrics provides an important basis for the meaningful analysis of the relationship between controlling and minority shareholders in an environment of concentrated ownership.

B. THE ENTRENCHMENT INDEX

Entrenchment of the incumbent structure of ownership may be a considerable concern in the context of concentrated ownership. The size of their holdings and the resultant voting rights often give controlling shareholders a de facto veto over control transactions. There has been some concern that corporate governance systems based on concentrated ownership are insufficiently effective at monitoring controlling shareholders. There seems to be a lack of effective mechanisms for restricting the ability of controlling shareholders to disenfranchise minority shareholders and for challenging the control of incumbent controlling shareholders when they no longer contribute to the enterprise.[85] Entrenchment is not a phenomenon limited to controlling shareholders, however. It appears that control is often concentrated and difficult to challenge, regardless of governance and ownership structures.[86]

Bebchuk, Cohen & Ferrell emphasize the importance of identifying variables in corporate governance indices that are relevant and effective, and in their study they focus on mechanisms that address entrenchment in the context of dispersed ownership.[87] Their work is based on the selection of relevant measurement variables from a broader index of metrics developed by Gompers, Ishii & Metrick, where each metric was given a similar weight in the index. The variables Bebchuk, Cohen & Ferrell identify include constitutional limitations on shareholder voting power (staggered boards, limits to amend by laws and supermajority requirements for mergers and charter amendments), as well as takeover readiness, reflecting the defensive posture of management (poison pills and golden parachutes). These mechanisms are less relevant in the context of concentrated ownership, of course. However, their approach highlights entrenchment as a key concern in corporate governance. As discussed above, this concern is certainly relevant in the context of concentrated ownership and warrants separate variables for that environment as well. Another important contribution made by Bebchuk, Cohen & Ferrell is the recognition that not all corporate governance mechanisms necessarily have the same relevance, and hence care should be taken to the weight each is given in an index.[88]

[83] *Id.* at 74.
[84] Pistor (2000), *supra* note 75, at 71-72.
[85] Becht, Bolton & Röell (2002), *supra* note 22, at 17-21, *see also* Bebchuk (1994), *supra* note 53.
[86] *See* Pacces, *supra* note 42.
[87] *See* Bebchuk, Cohen & Ferrell (2004), *supra* note 72.
[88] *Id.* at 1-2.

Entrenchment mechanisms used in the context of concentrated ownership typically include control enhancing mechanisms, such as multiple share classes or extra voting rights granted on the basis of holding shares for a requisite time. Control can also be enhanced through pyramids or cross-shareholdings, for example. However, it should be noted that some of these mechanisms may be complementary to a concentrated ownership environment. In a corporate environment where concentrated ownership provides a successful monitoring mechanism, control enhancing mechanisms can be used to leverage this mechanism.[89] Thus, it is not clear that these mechanisms are detrimental *per se*, provided the potential for abusing them is appropriately addressed.

However, it is still the case that mechanisms should be available to decrease entrenchment and enable transfer of control or change of ownership where the incumbent shareholder no longer provides an effective monitoring function. Mechanisms could be developed that induce such changes without directly challenging the ability to control the corporation. One approach to this situation is to first ensure that the ability of controlling shareholders to extract private benefits of control is limited, then introduce mechanisms that limit any negative impact of the transfer of control for controlling shareholders and that indeed encourage such transfers, and finally make maintaining controlling positions less appealing (in relative terms) if corporate performance is unsatisfactory.

In a concentrated ownership environment, an entrenchment index should include – as a basis – corporate governance mechanisms related to the regulation of self-dealing and related party transactions. An effective anti-entrenchment policy, where the control of controlling shareholders is not directly challenged, is premised on restricting private benefits of control. In addition, the metrics would then include dividend taxation in corporate pyramids and taxation of transfer of control positions by controlling shareholders. In several jurisdictions dividend taxation allows tax free payments of dividends in a pyramid – facilitating the use of pyramid systems.[90] High income taxes on transfer of control positions may also prevent controlling shareholders from selling even when such sale would be otherwise justified and in the interest of all the company's shareholders. Finally, the ability of controlling shareholders to take advantage of losses in controlled companies for their own tax purposes, would again be an example of a disincentive to sell the position, even when performance was loss-making.

C. PROTECTING MINORITY SHAREHOLDERS

Djankov et al. have introduced an index specifically adapted to concentrated ownership.[91] The index is based on a functional analysis of mechanisms available to protect outside investors against self-dealing transactions. The index consists of elements related to private and public enforcement for controlling self-dealing and stock market development. Private enforcement (ex ante and ex post) variables include disclosure obligations and requirements for approval by disinterested shareholders, as well as standing to sue for minority shareholders and the assessment of the prerequisites for successful actions (access to evidence and burden of proof). Public enforcement variables include sanctions imposed on inappropriate self-dealing (including tax evasion), while stock market development variables include stock market

[89] *See* Gilson (2006), *supra* note 36.

[90] *See* Randall Morck, *How to Eliminate Pyramidal Business Groups: The Double taxation of Intercorporate Dividends and Other Incisive Uses of Tax Policy* 136 in TAX POLICY AND THE ECONOMY, VOLUME 19 (James M. Poterba, ed., 2005).

[91] *See* Djankov et al. (2008), *supra* note 71.

capitalization, control premiums in control transactions, the number of listed firms and IPOs (in relation to population / GDP) and the level of ownership concentration.

The index clearly identifies certain key characteristics of a concentrated ownership environment. Self-dealing is a key concern in this environment. The index also correctly identifies disclosure obligations and public enforcement as key variables.[92] However, approval by disinterested shareholders might not be an appropriate mechanism in this environment, given applicable coordination problems. In fact, minority shareholders may well be driven by opportunistic agendas if they had the right to approve related-party transactions with controlling shareholders. Moreover, mere standing to sue may again be problematic, considering the coordination problems of dispersed and diversified minority shareholders. An advantage of the Djankov et al. index is its inclusion of an assessment of the prerequisites for successful actions, and especially the burden of proof.[93] With respect to self-dealing, a reverse burden of proof might well be introduced to ensure related-party transactions involving controlling shareholders are of an arm's length nature. Importantly, this mechanism would not prevent related-party transactions or challenge the control of the incumbent shareholder. Mechanisms may still be needed to regulate the imbalance in the risks of legal action for minority shareholders (such as class actions, specialized courts or the ability of independent agencies or ombudsmen to take action, for example).

Anti-Block Mechanisms

A number of mechanisms identified in the LLSV index or by other scholars are also relevant in the context of concentrated ownership. Pistor has identified the following mechanisms as "Anti-block" mechanisms potentially relevant in the context of concentrated ownership[94]:

i. Cumulative voting (and other rules ensuring proportional board representation)
ii. Minority recourse against general meeting decisions
iii. Pre-emptive rights of shareholders
iv. A general meeting quorum requirement
v. A minority right to require redemption
vi. Mandatory takeover bid thresholds
vii. Disclosure requirement of block acquisitions

The index outlined above, with rules allowing shareholders to liquidate their investment, is also relevant in the context of concentrated ownership. The index includes rules whereby (i) the right to transfer shares is not restricted by law (and may not be limited by charter), (ii) any formal requirements for transferring shares are limited to endorsement and registration, (iii) minority shareholders have a put-option in case they oppose major transactions, including mergers, reorganization, sale of major assets, charter changes etc., and (iv) a mandatory takeover bid is triggered at a certain level of ownership (25%, 30% or 50%). Other mechanisms in the LLSV and Pistor indices that are relevant in the context of concentrated ownership include (i) the minority right to convene a general meeting, (ii) minimum dividend, (iii) mandatory one-share-one-vote systems, (iv) the minority right to establish an audit commission and (v) qualified majority requirements for fundamental decisions.

[92] *Id.* at 463.
[93] *Id.*
[94] *See* Pistor (2000), supra note 75.

Bebchuk & Hamdani also focus on corporate governance metrics in the context of concentrated ownership and identify certain key factors in this context, including (i) the allocation of power between majority and minority shareholders, (ii) the regulation of self-dealing and freezeouts, and (iii) director independence. They argue that the ability of minority shareholders to block certain fundamental transactions may be an important element of corporate governance. Self-dealing, on the other hand, is usually a key concern in the context of concentrated ownership, and mechanisms for addressing this could include disclosure, voting requirements and fiduciary duties.[95] Finally, in a concentrated ownership environment, director independence should be assessed in relation to the controlling shareholder, of course, while in dispersed ownership independence should be assessed in relation to management.[96]

Martynova & Renneboog have constructed a corporate governance index for EU member states including separate indices for protecting shareholder interests with respect to management, minority interests with respect to the controlling shareholders, and creditor interests with respect to shareholders.[97] Martynova & Renneboog take a functional approach, identifying regulation of all types that protects and enforce the interests above. They categorize protective measures based on the legal strategy applied and identify the following instruments as relevant for the purposes of the protection of minority shareholder interests:

Appointment Rights: (i) mandatory minority board representation, (ii) rules allowing voting caps, (iii) a ban on dual-class shares.

Decision Rights: (i) supermajority requirements for general meetings, (ii) the right to convene a general meeting. Scores in the index depend on the level of shareholdings applied to the provisions above.

Trusteeship strategy: The strategy aims at ensuring board independence from the controlling shareholder, and the relevant corporate governance mechanisms include (i) non-shareholder-elected board members and (ii) a ban on the CEO acting as chairman of the board (in 1-tier board structures) and a clear ban on overlaps between management and supervisory boards (in 2-tier board structures).

Affiliation Rights: (i) an equal treatment rule, (ii) disclosure of block-holdings, (iii) a mandatory bid rule, (iv) a sell-out rule, (v) a minority claim right in cases of expropriation and (vi) a break-through rule eliminating super voting rights in takeover situations.

Lele & Siems have constructed more comprehensive indices for both shareholder protection and minority protection.[98] The authors' goal was to compare the development of corporate governance regulation in different jurisdictions, and their indices emphasize variables that reflect differences in corporate governance systems. The authors also focused on coding to provide a fuller body of measurement variables. Their index for minority protection includes the following elements:

---

[95] Bebchuk & Hamdani (2009), *supra* note 2, at 46.

[96] *Id.*

[97] Martynova & Renneboog (2010), supra note 1, at 3.

[98] *See* Priya P. Lele & Mathias M. Siems, *Shareholder Protection: A Leximetric Approach,* 7 J. OF CORP. L ST. 17 (2007).

1. Quorum	1 for a 50% quorum for an extraordinary shareholders' meeting (when it is called for the first time); 0.5 fora 1/3 quorum; 0.25 for a 1/4 quorum; 0 otherwise.
2. Supermajority	1 if supermajority requirements (2/3 or 3/4) apply for amendments of articles of association, mergers, and voluntary liquidations; 0 if no such rules exist.
3. One share – one vote	(1) Default rule: 1 if the principle exists as a default rule; 0 otherwise. (2) Multiple voting rights prohibited: 1 if prohibited; 2/3 if "grandfather clause" applied, i.e., allowed only for companies that already have them; 1/3 if government approval required; 0 otherwise. (3) Capped voting rights prohibited: 1 if prohibited; 2/3 if allowed only for companies that already have them; 1/3 if government approval required; 0 otherwise.
4. Cumulative voting	1 if shareholders can cast all their votes for one candidate or if there is a proportional representation mechanism for the board by which minority interests may name a proportional number of directors (default or mandatory law); 0 otherwise.
5. Voting by interested shareholders prohibited	1 if a shareholder cannot vote if the vote favors him or her personally (i.e., only "disinterested shareholders" can vote); 0 otherwise.
6. No squeeze out	0 if a shareholder holding 90% or more can "squeeze out" the minority; 1 otherwise.
7. Right to exit	(1) Appraisal rights: 1 if they exist for mergers, amendments of articles and sales of major company assets; 0 if they do not exist at all. (2) Mandatory bid: 1 if there is a mandatory bid for the remaining shares in case of purchase of 30% or 1/3 of the shares; 0 if there is no mandatory bid at all. (3) Mandatory public offer: 1 if there is a mandatory public offer for purchase of 10% or less of shares; 0.5 if the buyer has to make a mandatory public offer for acquiring more than 10% but less than 30% of the shares; 0 otherwise.
8. Disclosure of major share ownership	1 if shareholders who acquire at least 3% of the capital have to disclose; 0.75 if the trigger is 5%; 0.5 if the trigger is 10%; 0.25 if the trigger is 25%; 0 otherwise
9. Oppressed minority	(1) Substantive law: 0 if the majority decisions of the general meeting have to be accepted by the outvoted minority; equals 1 if some kind of substantive control is possible (e.g., in cases of amendments to the articles of association, ratification of management misconduct, exclusion of the pre-emption right, related parties transactions, freeze outs); 0.5 if this control covers only flagrant abuses of majority power. (2) Shareholder action: 1 if every shareholder can file a claim against a resolution by the general meeting because he or she regards it as void or voidable; 0.5 if there are hurdles such as a threshold of at least 10% voting rights or cost rules; equals 0 if this kind of shareholder action does not exist.
10. Shareholder protection is mandatory	(1) Exclusion of director's duty of care in articles: 0 if possible and 1 otherwise. (2) Rules on duration of director's appointment: 1 if mandatory and 0 otherwise. (3) Board composition (supervisory boards, non-executive directors): equals 1 if mandatory and 0 otherwise. (4) Other topics: 1 if there is a general rule that company law is mandatory; 0 if company law is a "model off the shelf"; 0.5 if there is no general rule.

The indices outlined above emphasize the need to separately assess the quality of corporate governance systems with regard to the relationship between controlling and minority shareholders. The indices provide a number of similar metrics in this regard. Below, this study analyzes the application of these metrics in an environment of concentrated ownership, and seeks to identify corporate governance mechanisms that are adapted to a concentrated ownership environment and that also provide useful information on the quality of the governance system.

D. ASSESSING MECHANISMS FOR CONCENTRATED OWNERSHIP

The effects of regulatory mechanisms can vary considerably depending on the specific institutional environment. An environment of concentrated ownership may support certain mechanisms and institutions, while others may be less relevant. The basic premise is that large shareholders have considerable interests to pursue through corporate governance mechanisms, whereas smaller diversified shareholders will face coordination problems when pursuing monitoring action. Thus, different types of regulatory intervention are required to address the interests of these different constituencies.

Governance Strategies and Regulatory Strategies

A number of corporate governance mechanisms are either less relevant in an environment of concentrated ownership or function differently than in dispersed ownership systems. Legal strategies for protecting minority interests in concentrated ownership should principally include regulatory strategies, such as rules and standards and entry and exit rights. Enforcement of these strategies may require action by public agencies to overcome coordination problems. This could entail a focus on securities regulation and tax regulation, for example, and the ability of independent agencies to enforce minority interests. Anti-block mechanisms should also be assessed from this perspective.

In an environment of concentrated ownership, controlling shareholders are generally able to pursue their interests independently. Consequently, it is likely that governance strategies will be employed with respect to the relationship between shareholders and managers. For example, in an environment with large shareholders the right to appoint and remove directors will probably be effective. Minority shareholders, however, are not in a similar position to defend their interests, and with respect to the relationship between controlling shareholders and minority shareholders, regulatory strategies are often required. Thus, standards for director behavior are important in this context. Standards may also be needed to protect minority shareholders from potential abuse by controlling shareholders. Entry and exit rights are also important for minority shareholders and are reflected in such mechanisms as mandatory bid rules. Similarly, large shareholders might be able to enforce their rights through private means, whereas minority shareholders would need recourse to public enforcement. An interesting question is whether some governance strategies might also be suitable for the relationship between controlling shareholders and minority shareholders. For example, rather than seeking to attempt to provide mechanisms that challenge the control of large shareholders, regulation might instead strive to incentivize controlling shareholders to transfer control when appropriate.

Less relevant aspects of corporate governance in the context of concentrated ownership include takeover defense regulation (addressing poison pills, for example), and shareholder voting procedures. A controlling shareholder will generally have an effective veto on control transactions, and so control is not contestable in the same manner as in companies with dispersed ownership. Shareholder voting procedures are not without merit, but they lack the importance they have in dispersed ownership environments. In fact, with respect to the protection of minority interests, it should be emphasized that shareholder voting rights, or "voice," are merely one corporate governance mechanism, and there may be other functionally equivalent mechanisms that can be used.

An important aspect of corporate governance is that the legitimate interests of the "agent" must also be protected. In order to allow the "agent" to make firm-specific investments, there must be some guarantees that they will not be confiscated by the "principals." For the purposes of corporate governance regulation, recognition of the rights of the controlling constituents (or agents) may be just as important as acknowledgement of the need to protect minority shareholders.[99] The ability to use decision rights is usually of paramount importance to controlling shareholders and – considering, for example, their typically undiversified and illiquid holdings – provides the basis for their ability to create value on their investment and manage their investment risk.[100] The ability of minority shareholders to challenge their control can undermine the basis of their investment and, in fact, can be seen by controlling shareholders as attempted confiscation of their property. Indeed, when risk profiles are sufficiently different, minority shareholders with potentially limited risks and a diversified portfolio could well use minority rights against a heavily invested controlling shareholder in an opportunistic manner. If minority shareholders are granted veto-rights on corporate transactions, they may well take advantage of their different risk profile, and consequent strengthened bargaining position, to require special treatment or unwarranted premiums. Thus, a corporate governance index for concentrated ownership should not favor such mechanisms as break-through rules, or emphasize the veto rights of minority shareholders, provided sufficient protections are in place to protect their cash-flow and exit rights. In a concentrated ownership environment, it may also be important that large shareholders are able to rearrange their holdings and manage their investments. Mechanisms can be introduced that balance the ability of controlling shareholders to control the use of corporate assets and the cash-flow rights of the minority. Redemption rights and exemptions from mandatory bid schemes, for example, can be relevant in this regard.

Below, this study briefly assesses some of the key metrics used in the indices discussed above in this section.

Voting Rights

Anti-Block mechanisms and their related measurement variables include the use of voting rights by minority shareholders – including cumulative voting and qualified majority requirements. However, it is unclear whether mechanisms related to voting rights are key elements for protecting minority interests in an environment of concentrated environment. Decision rights, such as election of board members and requirements for management proposals to be confirmed by shareholders, are deemed governance strategies that require a level of coordination among shareholders. Decision rights are certainly important, as they relate to the ability of shareholders to monitor management. In a concentrated ownership environment, this monitoring is conducted by the controlling shareholder, however.

[99] Goshen & Hamdani (2013), *supra* note 49, at 560.
[100] VEIKKO VAHTERA, OSAKEOMISTUKSEN RISKI JA SÄÄNTELY [The Risks and Regulation of Share Ownership] (2011), at 411-416.

Nevertheless, it is certainly important that the controlling shareholder cannot wantonly make fundamental changes to the company. In this respect, qualified majority requirements for significant corporate decisions, such as mergers or changes of the corporate charter or articles, can be seen as a relevant mechanism for minority protection. However, a more important question is the extent to which the minority should have veto rights, or indeed whether exit rights are the more appropriate (or alternative) mechanism for these types of situations. As discussed earlier, the need to protect the interests of the controlling shareholder must also be recognized when choosing legal strategies. In this regard, the balance between qualified majority requirements and minority exit rights can be seen as the result of bargaining between corporate constituencies.

Cumulative voting for board positions has been introduced in certain jurisdictions[101] in such a way that minority shareholders can elect a limited number of board members while still allowing the controlling shareholder to control the board. Nonetheless, it is unclear whether cumulative voting is a necessary element of this mechanism, as minority shareholders still need to overcome coordination problems to make effective use of their voting rights. In other jurisdictions, corporate governance codes or stock exchange rules require that the board include members that are independent of large shareholders, which can provide a functional equivalent to cumulative voting.

An important feature in many regions across the EU is the use of control structures that support the concentration of control in listed companies.[102] In these structures control is generally separated by various means from cash-flow rights, allowing certain shareholders to retain a higher degree of control over a company than their relative share of equity ownership would suggest. The most common control mechanisms in use in the EU include pyramid structures, multiple share classes, shareholders' agreements, as well as voting and ownership caps.[103] In a structure with multiple share classes, different voting rights are attached to different classes of shares. By retaining shares of a class with high voting rights, a controlling shareholder is able to retain control of a company even if it issues new shares, providing they have low voting rights.

Control enhancing mechanisms can, in fact, be seen as complementary mechanisms used to leverage the monitoring function of controlling shareholders in the absence of alternative governance institutions. Through control enhancing mechanisms, controlling shareholders can obtain economies of scale and decrease firm specific risk.[104] Nonetheless, the opposite view, according to which the differentiation of cash flow and voting rights increases the potential for majority shareholders to pursue their own benefits, must also be recognized. The premise,

---

[101] Luca Enriques, Henry Hansmann & Renier Kraakman, *The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies*, 89, 91, in Kraakman et al (2009), *supra* note 15.
[102] *See* Grant & Kirchmaier (2004), *supra* note 67.
[103] Shearman & Sterling, *Proportionality Between Ownership and Control in EU Listed Companies* 25 (External Study Commissioned by the European Commission, May 18, 2007, Open Call for Tender No MARKT/2006/15/F), *available at* ec.europa.eu/internal_market/company/docs/shareholders/study/final_report_en.pdf [hereinafter EU Proportionality Report].
[104] Ronald J. Gilson & Alan Schwartz, *Constraints on Private Benefits of Control: Ex Ante Control Mechanisms versus Ex Post Transaction Review* 4 (ECGI Law Working Paper 194, 2012), *available at* http://ssrn.com/abstract=2129502.

then, that control enhancing mechanisms can serve a legitimate governance purpose, must be based on the application of effective limits on the extraction of private benefits of control.[105]

On a general level, parties should have freedom of contract with respect to different corporate finance and corporate governance structures. The promotion of specific structures of governance or ownership through regulation is generally unwarranted. For example, it can be argued that introducing the concept of one-share-one-vote would be an inappropriate limitation of the outcomes of bargaining and freedom of contract.[106] However, adopting this approach does not mean that regulatory intervention is unwarranted as such. It is clear that different corporate governance structures are vulnerable to abuse in different ways, and there is no guarantee against the various corporate constituencies being primarily driven by self-interest at the cost of others. The possibility of abuse must be recognized and addressed in the context of the institutional environment.

Minority Recourse

Anti-Block metrics also include the requirement for minority recourse against decisions by the general meeting. The possibility of ex-post assessment of corporate decisions may be a valid requirement; however, to be relevant minority recourse against general meeting decisions would require facilitation by public enforcement institutions. As discussed, minority shareholders face coordination problems, as they individually carry the full risk of a negative outcome in the courts, while they are only entitled to their pro rata share of a positive outcome. Moreover, if minority shareholders have diversified their investments, they have even lower incentives to pursue their rights through the court system.

Special features may need to be introduced to facilitate minority interests. For example, specialized courts or agencies may be needed to improve the balance of interests and related risks between controlling and minority shareholders in such situations. With respect to assessing the appropriateness of related-party transactions, it could also be possible to introduce fiduciary duties for the controlling shareholder and/or include provisions on the burden of proof in shareholder litigation in such cases (i.e., introducing such measures as entire fairness standards). Trusteeship strategies could also be introduced. For example, the possibility of requiring a special audit provides the minority with an avenue to address inappropriate related-party transactions. The mechanism is sometimes deemed invasive, and may impede the on-going business of a corporation. However, the mechanism does provide the possibility of a professional review of corporate records to reveal potential wrongdoing without challenging control, and without unduly burdening the minority shareholders so as to make the mechanism irrelevant.

Pre-emptive Rights and the Equal Treatment of Shareholders

The equal treatment principle often applied in company law is an important element of minority protection. As a sharing rule it provides a governance strategy whereby the controlling shareholder's returns are tied to those of the minority – on a pro rata basis.[107]

---

[105] *See* Bebchuk, Kraakman & Triantis (2002), *supra* note 47.
[106] Peter Nobel, *Stakeholders and the Legal Theory of the Corporation*, in PERSPECTIVES IN COMPANY LAW AND FINANCIAL REGULATION 176, 177 (Michael Tison, Hans de Wulf, Christoph van der Elst & Reinhard Steennot, eds., 2009).
[107] Armour, Hansmann & Kraakman (2009), *supra* note 27, at 42.

The pre-emptive rights of shareholders represent an important standard of company law related to the equality of shareholders, which as a principle may provide a significant benchmark for setting standards and rules related to the actions of a controlling shareholder. Such actions would include related-party transactions, dividend payments (or the decision not to pay dividends), and the issue of new shares. Thus, provided satisfactory enforcement or ex post assessments mechanisms are included, this could be an important metric for assessing minority protection.

Cash-flow and Exit Rights

Cash-flow and exit rights can be useful minority protection mechanisms, which potentially shield financial investments in the absence of "voice." In many respects, "exit rights" provide a functional equivalent or fall-back for "voice." Indeed, the individual investments of diversified minority shareholders often represent just part of a financial portfolio. In this respect, an exit right at fair value provides a liquidity event allowing a similar financial reinvestment. This can allow for efficient regulatory bargains between shareholders focusing on control rights and those prioritizing the financial aspects of the investment. The controlling shareholder could be granted broader control rights in exchange for increased liquidity for the minority shareholders.

The minority dividend right protects the minority from abuse by the majority owners in the form of "starving." Controlling shareholders may be in a different position to extract returns on their investments than minority shareholders. However, minority dividend provisions may also be subject to manipulation even when they are applied, and effective protection requires that the calculation of the dividend be appropriately regulated. Certain related-party transactions, such as group contributions, could be disqualified from the calculations, for example.

Minority redemption rights are typically applied when a large shareholder obtains a sufficiently sizeable majority. This allows the majority shareholder to redeem all remaining shares, but it also provides an exit for the minority. The redemption threshold, often 90 percent or higher of all shares and votes, could be made subject to some discretion and linked to the availability of relevant minority protection mechanisms. Where such mechanisms are no longer available, the possibility of redemption may be an equitable outcome. Often, however, the influence of minority shareholders is insignificant where a controlling shareholder holds close to 90 percent of shares, and there could be arguments for lowering the threshold closer to the level where the minority has effective veto rights on significant corporate decisions. This could also increase "deal security" and the ability of controlling shareholders to pursue corporate transactions or rearrange their holdings.

Redemption rights may also apply in connection with significant corporate transactions, such as mergers. In some countries, redemption rights also apply in connection with significant changes to the corporate charter. Typically, such rights are triggered where the changes negatively affect the rights of shareholders (such as changing the rights of a class of shares, for example).[108] However, it has been argued that in some of these situations exit rights are not necessarily justified.[109] A merger or change in the company's articles of association, for

[108] Edward Rock, Paul Davies, Hideki Kanda & Reinier Kraakman, *Fundamental Changes*, 183, 185 in Kraakman et al (2009), *supra* note 15.
[109] Vahtera (2011), *supra* note 100, at 329 and 359; *but see* TIMO KAISANLAHTI, SIDOSRYHMÄT JA RISKI PÖRSSIYHTIÖSSÄ [INTEREST GROUPS AND RISK IN A LISTED COMPANY] 73-74 (1998).

example, has been seen to reflect the outcome of arm's length corporate decisions where qualified majority requirements provide sufficient protection for the minority. However, it is also possible to see an exit-right mechanism as a trade-off. For example, qualified majority requirements may have been set at a lower level in exchange for exit rights. In some countries (including the Nordics) mergers, for example, are approved by a majority of 2/3 of the votes and shares in attendance at a general meeting, but there are jurisdictions with higher majority requirements or majority requirements linked to the total number of outstanding shares.[110] Lower majority requirements allow controlling shareholders to use their control rights to restructure the business enterprise, but they also provide increased minority protection. The different specific majority requirements reflect different policy outcomes.

Nevertheless, as a minority protection mechanism, a redemption right provides increased liquidity when a fundamental change is introduced that can have a significant effect on the investment of a minority shareholder, and where the shareholder is unwilling to pursue an investment with a different risk profile. Under such circumstances, the redemption right can, in fact, be seen as an extension of a functional equivalent to a veto right (i.e., "voice"). Moreover, the redemption right is a preferable mechanism to veto rights in that it does not challenge the decision rights of the controlling shareholder, thereby allowing changes in the corporation to take place.

The mandatory bid mechanism also provides exit rights for minority shareholders; however, it is unclear whether the mandatory bid mechanism is appropriate under all circumstances in a concentrated ownership environment. The mandatory bid rule prevents inefficient transactions where the value sought by the bidder would be extracted from the target company at the cost of the other shareholders rather than from increased efficiency or synergies. However, the rule also generally limits the possibility of paying control premiums to controlling shareholders in change of control transactions. Thus, the mandatory bid rule may protect minority shareholders, but it can also increase the price of takeovers and discourage bidders from making takeover bids in the first place – even if they are potentially value-creating.[111] Therefore, the mandatory bid rule can have negative implications in an environment with concentrated ownership, as it reduces trade in control positions. It has been argued, however, that as a matter of principle, the mandatory bid rule can neither be deemed clearly superior nor inferior to other functionally equivalent mechanisms; rather, the effect of the rule depends on the applicable actual circumstances.[112] In cases where buyers can extract significant private benefits of control at the cost of the minority shareholder, a mandatory bid rule may be called for. However, if the extraction of private benefits of control by a new buyer is effectively restricted, there should be no need for a mandatory bid rule.[113] This suggests that the application of the mandatory bid rule should be selective and based on the applicable level of minority protection mechanisms.

Disclosure Requirements

Pistor et al. mention disclosure of block-holding positions as an anti-block mechanism. This provides the means for shareholders to monitor whether a control position is being pursued or

[110] Rock et al (2009), *supra* note 108, at 197-198.
[111] Marc Goergen, Marina Martynova & Luc Renneboog, *Corporate Governance Convergence: Evidence from Takeover Regulation* 11 (ECGI working paper No. 33/2005), available at http://ssrn.com/abstract=709023.
[112] Erik Berglöf, & Mark Burkart, *European Takeover Regulation*, 18 ECON. POLICY 171, 175 (2003), *available at* http://www.jstor.org/stable/1344656.
[113] *See* Gilson & Gordon (2003), *supra* note 39.

if such a position is transferred. Disclosure rules are more generally an important element of minority protection. Increased transparency allows for better monitoring of related-party transactions and how control positions are used, while not challenging the control position itself. Disclosure rules are often part of securities regulation and are enforced by public authorities. Provided the quality of the regulatory framework is adequate, this also improves the position of minority shareholders, who may be insufficiently incentivized to engage in monitoring by themselves. Disclosure rules are therefore generally an appropriate – even preferred – mechanism in a concentrated ownership environment.

Trusteeship Arrangements

Trusteeship arrangements can also be applied for the purposes of monitoring the actions of controlling shareholders. As discussed earlier, a mechanism which ensures that the board includes members who do not represent the interests of a controlling shareholder may well be warranted in an environment of concentrated ownership. The independent board members could perform a gatekeeper or trusteeship function provided they have the proper authority and incentive to carry out their monitoring duties (personal liability, for example). In addition to independent directors, external parties, such as auditors or independent financial experts, have also been used as trustees. It is possible, for example, to require statements from independent experts to support the arm's length nature of related-party transactions.

The broader efficacy of gatekeeper or trusteeship arrangements has nevertheless been called into question.[114] It is unclear whether trustees are always properly incentivized to conduct monitoring or whether they have been granted adequate authority in this regard. Overall, trusteeship arrangements can be seen as a complementary mechanism used to enhance other minority protection mechanisms.

F. A Corporate Governance Index for Concentrated Ownership

Based on its analysis of the indices discussed above, this chapter now provides an outline for a minority protection index for corporate governance systems based on concentrated ownership.

In a system with a prevalence of concentrated ownership, it is assumed that large shareholders monitor management, and have satisfactory means to do so, as suggested by Olson[115] and Kraakman et al.[116] As there are often companies with different types of ownership structures in a given jurisdiction, a single index may be insufficient for describing the quality of the corporate governance system as a whole. Moreover, Bebchuk & Hamdani suggest that indices for assessing the protection of minority rights should be kept separate from indices assessing shareholder rights in general. Aggregating these indices would allow manipulation of the score by promoting the regulation of relationships which are less relevant in the given environment.

The list below describes the key parameters for a minority protection index, as well as the various mechanisms that are relevant in each case. It is recognized that there may be functional equivalents for a number of mechanisms, and allowance is made for the development of metrics on this basis. The key parameters identified are (i) mechanisms for

---

[114] *See* John C. Coffee, Jr., *Understanding Enron: It's About the Gatekeepers, Stupid* (Columbia Law & Economics Working Paper No. 207, 2002), available at http://ssrn.com/abstract=325240.
[115] *See* Olson (1971), *supra* note 68.
[116] *See* Armour, Hansmann & Kraakman (2009), supra note 23.

restricting the extraction of private benefits of control by controlling shareholders, (ii) mechanisms providing an exit or cash-flow for minority shareholders (to protect them from "starving"), (iii) mechanisms to induce voluntary transfer of control (as break-through mechanisms or other mandatory provisions may undermine the basis of a concentrated ownership system), (iv) measurement variables for enforcement mechanisms for minority rights – to ease the coordination problems of minority shareholders.

The list of relevant parameters emphasizes certain characteristic features of concentrated ownership. First, it recognizes the coordination problems of minority shareholders and does not consider voting rights the primary mechanism for minority protection. While qualified majority requirements may be argued for in connection with significant corporate changes, the specific majority requirements can be balanced against exit rights. Second, minority shareholders may need to be supported by legal institutions to enforce their rights. Especially where ex-post standards are used to regulate the behavior of controlling shareholders, it may be necessary to provide mechanisms that decrease coordination costs (for example, special courts or a shifted burden of proof). Third, an important characteristic of concentrated ownership is that the controlling shareholder is able to control the use of corporate assets and has an effective veto, which cannot easily be challenged, on change of control transactions. Thus, other mechanisms may be warranted to induce a voluntary change of control (such as tax treatment of the transfer control). This also emphasizes the importance of understanding corporate governance regulation in broader terms and thus including regulation that has an overall effect on the relative positions of the key constituencies of the corporation.

PARAMETERS FOR AN INDEX FOR MINORITY PROTECTION

Availability of mechanisms to restrict private benefits of control (through tunneling)

- Qualified majority requirements for key corporate decisions (mergers, change of articles, deviation from pre-emption rights);

- Disclosure obligations regarding block-holding positions and related party transactions;

- Procedural requirements for related party transactions (third party approval or assessment; not necessarily by minority shareholders);

- Equal rights of shareholders (providing the legal basis for preventing private benefits of control or the disenfranchisement of minority shareholders);

- Requirement for independent directors or similar minority representatives.

Availability of mechanisms to protect cash-flow rights

- Mechanisms allowing for minimum dividends and for the redemption of minority shares (put and call) or mechanisms that require an offer to be made at fair price at 1) a set level of ownership and 2) in connection with significant changes to the corporate enterprise.

Mechanisms to induce voluntary transfer of control

- Neutral tax treatment for maintaining a set level of shareholdings;

- Neutral or favorable tax treatment of transferring control;

- Exemptions available from mandatory bid requirements.

Mechanisms for Facilitating Minority Coordination Problems for Effective Enforcement

- Entire fairness requirements and reversed burden of proof for related-party transactions;

- Availability of class action suits (especially in cases related to enforcement of standards, such as the principle of the equal treatment of shareholders);

- Special courts or tribunals for company law matters or agencies promoting minority interests (including takeover panels and special redemption proceedings);

- Public enforcement of securities laws (mandatory bid, redemption price assessment).

The parameters above provide a framework for assessing the quality of corporate governance systems with respect to the relationship between controlling and minority shareholders. The mechanisms for facilitating minority coordination problems and enforcement are, in part, functional equivalents. If class actions are available, for example, a reverse burden proof may be unnecessary. The relevance and weight of each mechanism should thus be assessed in the context of the institutional environment. With respect to the other parameters, the mechanisms identified each provide protective measures and should be weighted accordingly.

IV. ASSESSMENT OF NORDIC MODELS OF CORPORATE GOVERNANCE

This chapter discusses the key corporate governance mechanisms available in the Nordic region and then assesses how they reflect concerns related to a system with a high level of concentrated ownership.

A. INTRODUCTION

Nordic corporate governance has traditionally been characterized by relatively high levels of concentrated ownership and the application of different types of control mechanisms.[117] Yet, empirical studies report low levels of private benefits of control in these countries.[118] For example, certain studies have found the value of block-holdings in the Nordics to be at the same level as in Anglo-Saxon countries, a higher value for block-holdings representing the existence of private benefits of control linked to such blocks.[119]

Ownership concentration in the Nordic countries remains relatively high, with the largest shareholder having a reported average (mean of a data set of the largest listed companies) ownership share of 23.5 percent and the top five shareholders together a 44.8 percent share.[120] Ownership by key families has decreased, as have their spheres of influence; however, over 60 percent of companies in the Nordics still have at least one shareholder with over 20 percent of the votes and over 20 percent have a shareholder with more than 50 percent of the votes.[121] Foreign ownership has increased considerably since the 1980s, and new industries have

[117] *See* Johan E. Eklund, *Corporate Governance and Investments in Scandinavia – Ownership Concentration and Dual-class Equity Structure* (CESIS Electronic Working paper Series, 2007), *available at* http://www.infra.kth.se/cesis/documents/WP98.pdf.
[118] Martin Holmén & Peter Högfeldt, *Pyramidal Discounts: Tunneling or Agency Costs?* (ECGI Working Paper 73, 2005), *available at* http://ssrn.com/abstract=667743.
[119] Tatiana Nenova, *The value of corporate voting rights and control: A cross-country analysis*, 68 J. OF FIN. ECON. 325, 327 and 340 (2003).
[120] Eklund (2007), *supra* note 117, at 9.
[121] Högfeldt (2005), *supra* note 15, at 518-522, *and* Gilson (2014), *supra* note 33, at 99-100.

emerged to challenge the traditional dominance of heavy industry, such as natural resources and machinery based industries, that dominated the economies of Finland and Sweden during the larger part of the 20th century.

Control enhancing mechanisms supporting the control of incumbent shareholders are common in environments with concentrated ownership. Control enhancing mechanisms generally function by separating voting rights from cash-flow rights by different means, allowing incumbent shareholders to maintain a higher degree of control than their relative share of equity holdings would entitle them to. The control mechanisms used in the Nordic countries include multiple share classes, voting caps and pyramid ownership structures, for example.[122]

According to Eklund, in the Nordic countries the largest shareholder holds an average of more than 20 percent of the capital and close to 30 percent of the voting rights.[123] In Norway[124] some 14 percent of listed companies are reported to employ a dual-class share structure, while in Denmark and Finland the figure is more than 30 percent and in Sweden some 55 percent.[125] In turn, Faccio & Lang, report the use of dual-class share structures at 29 percent of listed companies in Denmark, 44 percent in Finland, 11 percent in Norway and 62 percent in Sweden.[126] The low figure for Norway has been explained by the fact that government authorization has been required for the introduction of dual-class share structures. As a compensating factor, Faccio & Lang report that 33 percent of listed companies in Norway had pyramid structures, while the corresponding share in the other Nordic countries was significantly lower.[127]

Despite the high levels of concentrated ownership and the use of control enhancing mechanisms, the reported private benefits of control appear low in the Nordic region. In analyses of the value of control-blocks, Nordic countries have fared very well. As mentioned earlier, a higher value for control-blocks represents the existence of private benefits of control linked to such blocks. However, in an analysis by Nenova,[128] the value of control-blocks was found to be a mere one percent or less of market capitalization in Nordic jurisdictions, while it was already four percent in the United States, for example.

However, in some corporate governance indices, Nordic countries receive only an average rating. Moreover, while the Nordic countries have achieved good ratings in the LLSV index, according to Nordic commentators their scores nevertheless fail to reflect the quality of their governance systems. The average score in the LLSV index, which groups countries according to legal families, was 3.00 for countries in the Scandinavian legal family, when it was 4.00 for countries in the English legal family and 2.33 for countries in the German legal family.[129]

[122] *See* the EU Proportionality Report, *supra* note 103.
[123] Eklund (2007), *supra* note 117, at 28.
[124] Oyvind Bohren & Bernt Arne Odegaard, *Corporate Governance and Economic Performance in Norwegian Listed Companies*, 21 (Norwegian School of Management Working Paper, 2001), available at http://finance-old.bi.no/~bernt/governance/Report_Performance.pdf.
[125] *See* Hans Tson Söderström, Erik Berglöf, Bengt Holmström, Peter Högfeldt & Eva M. Meyersson Milgrom, *Corporate Governance and Structural Change, European Challenges* (SNS Economic Policy Group Report, 2003) *available at* http://meyersson.com/ekoradet1-CorpGovEuropean.pdf.
[126] *See* Mara Faccio & Larry H.P. Lang, *The Ultimate Ownership of Western European Corporations,* 65 JFE 365, (2002).
[127] *Id.* at 380-381.
[128] Nenova (2003), *supra* note 119, at 340.
[129] La Porta et al. (1998), *supra* note 1, at 1122-1123 (explanations of variables) and 1131 (metrics for Scandinavian countries).

Furthermore, the acceptance of dual class share structures has raised concern about the Nordic model of corporate governance, despite the low value of control-blocks.

Below, different corporate governance indices including the Nordic countries are presented for comparative purposes:

LLSV Corporate Governance Index for the Scandinavian Legal Family[130]

	One share-One vote	Proxy by Mail Allo-wed	Shares not Blocked before Meeting	Cumulative Voting / Proportional Representation	Oppressed Minority	Preemptive Right to New Issues	Percentage to call an Extra-ordinary Shareholder Meeting	Anti-director Rights
Den-mark	0	0	1	0	0	0	.10	2
Finland	0	0	1	0	0	1	.10	3
Norway	0	1	1	0	0	1	.10	4
Sweden	0	0	1	0	0	1	.10	3

Martynova & Renneboog Minority Shareholder Rights Protection Index[131]

	Appointment Rights Strategy	Decision Rights Strategy	Trusteeship Strategy	Affiliation Strategy	Total Index
Denmark	2	2	0	8	12
Finland	1	2	2	5	10
Norway	1	2	2	7	12
Sweden	2	2	2	4	10
Scandinavian average	1.5	2	1.5	6.0	11
German legal origin average	2.0	2.7	1.3	8.3	14.3
English legal origin average	1.7	2.7	0.7	8.3	13.3

130 *Id.*

131 Martynova & Renneboog (2010), *supra* note 1, at 33-34.

Gourevitch & Shinn Minority Shareholder Protections Index[132]

Country	Information	Oversight	Control	Incentive	Total Index
Denmark	44	43	40	16	36
Finland	60	36	60	16	43
Norway	66	29	80	16	48
Sweden	67	36	60	22	46
Germany	44	29	20	41	33
UK	81	60	100	53	74
United States	86	100	100	100	97

While the LLSV analysis is important, it should be recognized that company laws have developed since then, and thus the scores should be recalculated. For example, in Finland oppressed minority provisions were included in the new Companies Act of 2006. Furthermore, international comparisons have been subject to much criticism. In terms of the analysis of the Nordic countries, criticism has focused on how the Nordic model has been graded, and a number of efforts have been made to describe the benefits and qualities of the model.[133] There have also been attempts to emphasize the effects of informal institutions as an explanation for why the moderate scores in corporate governance indices incorrectly reflect the quality of corporate governance in the Nordic region. Such explanations have been based, among others, on the effect of the social norms characteristic of the Nordic environment or on the non-pecuniary nature of control benefits (such as the social status associated with corporate ownership).[134] The "Small world" characteristics of ownership in Scandinavia, with its bearing on reputational factors have also been analyzed.[135] It has also been suggested that low levels of crime and high levels of tax compliance in the Nordic countries[136] help explain the behavior of controlling shareholders. Even the role of the press has been mentioned as a factor contributing to the better monitoring of controlling shareholders.[137]

A number of factors affect corporate governance relationships, and the framework for corporate governance regulation cannot be limited to corporate and securities laws and regulations. Tax laws can have a significant effect on the costs of corporate ownership. On a

[132] PETER GOUREVITCH & JAMES SHINN, POLITICAL POWER AND CORPORATE CONTROL 48 (2005).
[133] See Jesper Lau Hansen, *A Scandinavian Approach to Corporate Governance*, 50 SCANDINAVIAN STUDIES IN LAW 125 (2007), *and* Lekvall (ed.) (2014), *supra* note 33.
[134] *See* Gilson (2006), *supra* note 36.
[135] Evis Sinani, Anna Stafsudd, Steen Thomsen, Christopher Edling & Trond Randoy, *Corporate Governance in Scandinavia: Comparing Networks and Formal Institutions*, 5 EUR. MANAGEMENT REV. 27 (2008).
[136] *See* John C. Coffee Jr., *Do Norms Matter?: A Cross-Country Examination of the Private Benefits of Control* (Columbia Law School Center for Law and Economic Studies Working Paper No. 183, 2001), *available at* http://papers.ssrn.com/Paper.taf?abstract_id=257613.
[137] See Alexander Dyck & Luigi Zingales, *The Corporate Governance Role of the Media* in THE RIGHT TO TELL: THE ROLE OF MEDIA IN DEVELOPMENT 107 (Roumeen Islam. ed., 2002).

general level, the effects of informal institutions can also certainly be recognized.[138] On a macro level they may well provide proxies for the quality of the governance system in general. However, these institutions may not provide (nor even be intended to provide) a sufficient basis for enforcement. For instance, it is unclear whether informal institutions have a sufficient impact in situations where the potential for conflicts of interest is accentuated, such as in takeovers or other end-game situations.

Political explanations for corporate governance and the political economy of the Nordic region should not be underestimated. Low levels of private benefits of control have also been linked to the broader political environment for corporate ownership. For example, Holmén & Högfeldt study pyramid structures in Sweden and indeed find increased agency costs in these types of structures.[139] Nevertheless, they find no indications of tunneling or the direct extraction of private benefits. They believe that controlling owners in financially developed countries such as Sweden are subject to more scrutiny based on well-developed accounting and judicial standards, and that there is less room for direct "stealing" in this type of environment. The authors suggest that the agency costs and discounts related to pyramid structures can be explained by investment behavior (over-investment) based on relatively inexpensive capital obtained from retained earnings as compared to external financing.[140] The cost of financing is affected, among others, by the favorable tax treatment of dividends in pyramid structures,[141] thus indicating political support for block-holding. In Sweden and Finland, dividends paid to legal entities are generally tax-exempt. Large shareholders can structure their holdings so that little tax is paid on dividend payments. In some other jurisdictions, pyramid ownership is efficiently restricted through dividend taxation.[142] The authors conclude that "[t]ax rules that regulate cash flows within the pyramid substitute for weak minority protection and limit incentives for outright stealing."[143]

In other words, controlling shareholders do obtain benefits from holding control blocks rather than diversified positions, but those benefits are based on the institutional environment and the tax system rather than on the direct transfer of wealth through "stealing" from minority shareholders. The explanation for the low levels of private benefits of control is thus at least in part political. Through political influence and bargaining, controlling shareholders have obtained favorable treatment for concentrated ownership. The Nordic corporate governance system may well restrict the extraction of private benefits of control directly from minority shareholders while still supporting control by large shareholders, but the background of the governance system is linked to a political approach to corporate governance.

B. SHAREHOLDER CONTROL RIGHTS

The Nordic model of corporate governance has been described as hierarchical, with the general meeting of shareholders having supreme authority over the other corporate bodies.[144] The general meeting has the authority to take key decisions regarding the company, from approving annual financial statements to decisions regarding key corporate transactions, such as mergers, and to electing and dismissing the board of directors. For example, under the

[138] *See* Sinani et al., *supra* note 135.
[139] Holmén & Högfeldt (2009), *supra* note 118, at 135-136.
[140] *Id.* at 170.
[141] *Id.* at 136-137.
[142] *See* Morck (2005), *supra* note 90.
[143] Holmén & Högfeldt (2009), *supra* note 118, at 172.
[144] JESPER LAU HANSEN, NORDIC COMPANY LAW – THE REGULATION OF PUBLIC COMPANIES IN DENMARK, FINLAND, ICELAND, NORWAY AND SWEDEN 74 (2003).

corporate laws of the Nordic countries, the general meeting of shareholders always has the right to elect the majority of the board of directors. Other decisions taken by the general meeting include changing the articles of association, the issuance of shares (or authorizing the board to issue shares), acquisition of the company's own shares and the liquidation of the company.

Through election and dismissal rights, in particular, the general meeting of shareholders can be seen to exercise control over the other corporate bodies, even if the general meeting is not generally intended to have executive powers. It should also be noted that staggered boards are typically prohibited under Nordic company laws. Thus, a general meeting is usually able to dismiss the board at any time – emphasizing the control of shareholders over management and the board of directors. The balance of power differs significantly from the more director-centric system in the United States, for example.

Decisions at shareholders' meetings are generally taken with a simple majority vote. Cumulative voting or similar voting systems are not typically applied. Decisions on significant corporate transactions, such as mergers or changes of articles of association, commonly require a minimum of two thirds of the votes given and the shares represented at the meeting. It should be pointed out, in particular, that where companies have different classes of shares, major corporate transactions, such as statutory mergers or demergers, must typically be approved by a qualified majority of the shares and votes in each class. Moreover, the issuance of new shares in deviation from pre-emptive rights (i.e. directed offerings) must be supported by a qualified majority and based on corporate requirements. Moreover, there is specific regulation of the pricing of new shares in such offerings to protect shareholders from dilution – generally shares must be issued at market price, with underpriced offerings potentially breaching equal treatment standards. Thus, groups of minority shareholders can veto the decisions of a controlling majority with respect to changes of articles of association, or mergers and directed share offerings.

It should be noted that there are generally no quorum requirements for shareholders' meetings, and it is usually sufficient for decisions to be passed that the relevant majorityof the shares present support the decision in question. However, in cases concerning changes to the rights related to shares, company laws typically require that the holders of the affected shares support the decisions as well.

The shareholder rights described above allow controlling shareholders to dominate corporate strategy, as can be expected in an environment with a tradition of concentrated ownership. The general meeting of shareholders provides a fairly effective means for a controlling shareholder to control the board and thereby direct corporate strategy. The lack of quorum requirements and cumulative voting supports the control rights of controlling shareholders. Minority shareholders have a voice with regard to significant transactions, such as mergers, and when articles of association are amended, but in other respects their powers are limited. Indeed, minority block-holders can find themselves with very little input or insight into corporate affairs when faced with a larger controlling shareholder.

C. Restricting Private Benefits of Control

The principle of equal treatment is a central element in Nordic company laws. The company laws of Finland and Sweden, for example, contain explicit provisions on the requirement that no decisions can be taken by corporate bodies (the general meeting or the board) that favor a shareholder or a third party at the cost of the company or the other shareholders.[145] Moreover, board members, pursuant to company law, can be directly liable to shareholders for decisions that would unduly disadvantage the minority.[146] It should also be noted that there is a reverse burden of proof in Finland with respect to related-party transactions involving board members and controlling shareholders alike,[147] and this principle can have practical implications for the types of corporate transactions companies can pursue.

Sweden has adopted requirements for related-party transactions in listed companies. For example, significant transactions with controlling shareholders are subject to approval by a general meeting, where the votes of the shareholder in question are not taken into account. An assessment of the transaction and related information must be made available to the shareholders in advance.[148] However, disclosure requirements regarding related-party transactions are less rigorous in Finland, being mainly based on IFRS rules, whereby disclosure occurs annually after the fact. In Finland, the financial supervisory authority monitoring IFRS compliance has noted that the quality of disclosure and compliance with IFRS rules on related-party transactions remains somewhat unsatisfactory. It should also be noted that EU prospectus regulations imposes comprehensive disclosure requirements for related-party transactions. The rules are applied when a listed company issues securities to the public (including to its shareholders) or applies for the listing of new securities on a stock exchange. More stringent regulation of related-party transactions is expected from the EU with the forthcoming amendments to the Shareholders' Rights Directive. In Finland, changes have been proposed to the Finnish Corporate Governance Code to require consideration of specific procedures for related-party transactions. However, requirements have not been introduced for third party statements or similar assessments – one reason perhaps being that EU guidance is still pending.

In Finland and Sweden shareholders with an aggregate of 10 percent of the shares in a company can require that a general meeting of shareholders be convened or that a special audit be carried out by an auditor for a specific purpose.[149] Moreover, management has the obligation to respond to shareholder queries at general meetings, provided the answers are unlikely to harm the company's business. These possibilities allow minority shareholders to gain some insight into possible tunneling.

Corporate governance codes for listed companies impose additional requirements on board members. For instance, requirements have been introduced with respect to the independence of board members and large shareholders. In Finland, for example, more than half of the board members of listed companies must be independent of the company (i.e., not recent employees) and two of these independent members must also be independent of large shareholders. Similar rules apply in the other Nordic countries.[150] Independent directors can

---

[145] CLAS BERGSTRÖM & PER SAMUELSSON, AKTIEBOLAGETS GRUNDPROBLEM [Basic Problems of the Stock Company] 168-174 (4th Ed. 2013); 1 JUHANI KYLÄKALLIO, OLLI IIROLA & KALLE KYLÄKALLIO, OSAKEYHTIÖ [The Stock Company] 537-542 (5th Ed. 2012); Hansen (2003), *supra* note 144, at 104-105.

[146] ROLF DOTEVALL, BOLAGSLEDNINGENS SKADESTÅNDSANSVAR [The Liability of Corporate Management] 231 (2nd ed. 2008), Kyläkallio, Iirola & Kyläkallio, *supra* note 88, at 566-573, Hansen (2003), *supra* note 144, at 118.

[147] Osakeyhtiölaki [Finnish Companies Act] 22:1-2.

[148] Aktiemarknadsnämndens uttalande [Swedish Securities Council Statement] 2012:5.

[149] Aktiebolagslagen [Swedish Companies Act] 7:13 and 10:21-23, and Finnish Companies Act 5:4 and 7:7.

[150] Securities Markets Association, Suomen listayhtiöiden hallinnointikoodi [Finnish Corporate Governance Code], Recommendations 14 and 15 (2010); *see also* Danish Corporate Governance Committee, Finnish Securities Market Association, Icelandic Committee on Corporate Governance, Norwegian Corporate

be a fairly important mechanism for minority protection, and in this sense, it is interesting that the requirement is only based on non-statutory corporate governance codes.

Increased transparency and improved practices for dealing with related-party transactions may well be warranted in the Nordic region. The position of independent board members may also need to be strengthened. Currently, the protection of minority interests relies on the integrity of a very limited number of directors.

D. PROTECTION OF MINORITY CASH-FLOW RIGHTS

In Finland and Sweden shareholders with a 10 percent holding can require a dividend payment of half the profits available for distribution from the last financial period.[151] The provision protects the minority from attempts by the controlling shareholder to "starve" the minority, for example. While the ten percent threshold can be deemed reasonable for the purposes of minority protection, minimum dividend rules should also address the possibility of the controlling shareholders taking measures aimed at minimizing the sums available for dividend payments. For example, while legitimate investments must be accepted, it is less clear that group contributions (i.e. the possibility to transfer funds to parent entities for accounting and tax purposes) should be taken into account in determining the minimum dividend.[152] The problem of controlling shareholders minimizing dividend payments should be addressed through regulatory means to ensure the provisions on dividend rights remain relevant.

A redemption obligation is in place in both Finland and Sweden. A shareholder holding more than 90 percent of the shares/votes of a company has the right and obligation to redeem the minority shares at a fair price. In both countries any disputes in this regard are settled in arbitration, with the arbitration costs carried by the redeeming shareholder.

In connection with certain transactions, minority shareholders may also have the right to require that their shares be redeemed at a fair value. For instance, in Finland shareholders opposing a merger have the right to have their shares redeemed at fair price. However, in Sweden no such right exists. It should also be noted that the exit rights of minority shareholders in Finland solely concern statutory mergers or demergers, not, for example, the sale of major assets or change of articles.

Mandatory bids also provide a mechanism for minority exit rights. In both Finland and Sweden, mandatory bids are triggered by a shareholder (acting alone or with concert parties) exceeding a holding of 30 percent of the votes of a listed company. In Finland, an additional threshold of 50 percent is also applied. In connection with mandatory bids, the price is based on the highest price paid by the party obliged to make the offer during a set period, unless the financial regulator decides otherwise. Thus, the financial regulator provides a monitoring function on behalf of the minority shareholders. As discussed earlier, however, it is unclear whether a transfer of control should trigger exit rights in every situation. It is not necessarily detrimental to minority shareholders if a control block is transferred from one shareholder to another – provided that private benefits of control cannot easily be extracted.

Governance Board, Swedish Corporate Governance Board, *Corporate Governance in the Nordic Countries* (2009).

[151] Swedish Companies Act 18:11 and Finnish Companies Act 13:7.

[152] *See* Finnish Supreme Court Ruling 2015:104; *see also* Helsinki Appellate Court Ruling S 10/1082, 3520, 29.11.2011.

Minority exit rights have received particular attention in connection with cash-mergers. It has been argued that the possibility of merging a listed company using a cash consideration can be used to circumvent the 90 percent threshold set for the redemption of minority shares. The majority required for a statutory merger in Finland and Sweden is two-thirds of the votes at a general meeting of shareholders. Under Swedish rules, however, at least half of the merger consideration must be in shares. In Finland, cash mergers are deemed possible though controversial, so much so that the Finnish Takeover Panel has issued a statement emphasizing the problematic nature of cash mergers and the implicit disenfranchisement of minority shareholders.[153] However, the amended Helsinki Takeover Code issued after this statement explicitly recognizes that cash mergers are possible in Finland in certain circumstances.[154] The fact that in Finland dissenting shareholders are allowed to require redemption at fair value in connection with mergers may have provided the basis for more flexibility in this regard.

Overall, Finland and Sweden have the relevant mechanisms to support minority cash-flow and exit rights. However, they may still require some adjustment. For example, when calculating the minimum dividend, provisions must ensure that the controlling shareholder cannot manipulate the amounts payable. Furthermore, the percentage payable and the percentage of votes required for the payment of the minimum dividend might also require adjustment.

E. Inducing Transfer of Control

If controlling shareholders are unable to extract private benefits of control, they should be incentivized to agree to control transfers on the same terms as minority shareholders. However, if private benefits are non-pecuniary (i.e., reputational considerations or social status), they may be more difficult to quantify, and thus it may be harder to induce control transfers.[155]

As discussed above, the Nordic corporate environment supports concentrated ownership in a way that can affect the decision to transfer control. For example, both Finland and Sweden have rules whereby dividend payments from listed companies are usually tax exempt for private corporations, provided their holdings exceed 10 percent of the shares in the target company. This allows dividends to be paid through pyramid structures, thus incurring lower taxes than when paid to beneficial holders directly. This may favor maintaining ownership at higher levels and lead to decisions on dividend payments by controlling shareholders that might otherwise be economically unsound.

On the other hand, in both countries shareholders with a position of over 10 percent of the shares in a listed company (in Finland this applies to private companies as well) can sell their shares without paying tax on profits. This provision may well induce transfer of control by virtue of tax savings in these situations.

F. Effective Enforcement

Countries in the Nordic region have generally scored well with respect to the quality of legal institutions and the overall rule of law. In La Porta et al., for example, the Nordic countries

---

153 Statement of the Takeover Panel 2009 on Merger Considerations.

154 The Helsinki Takeover Code, Recommendation 14, *available at* http://cgfinland.fi/files/2013/12/helsinki-takeover-codeweb.pdf.

155 Grant & Kirchmaier (2004), *supra* note 67, at 19-20.

received top scores in different legal enforcement metrics. In the World Bank's analysis, also referred to in the context of corporate governance indices, the Nordic region also does very well. However, this analysis misses certain key points.

As outlined by Kraakman et al., and as discussed earlier, the effectiveness of legal strategies depends, in part, on the ability of interested parties to overcome coordination problems. While smaller constituencies, such as large shareholders, are able to take advantage of governance rights, the interests of dispersed minority shareholders require specific regulatory strategies, such as rules or standards. In addition, coordination problems can significantly affect their ability to pursue and enforce their rights. As earlier discussed, if the financial interests of dispersed minority investors are limited and the risks related to litigation are high, there may be insufficient incentive for minority shareholders to pursue their interests through courts or other legal institutions. Moreover, it is unclear whether general courts are geared to address corporate law problems in a way that supports the enforcement of minority rights in a timely and cost-effective manner. Traditionally, the Nordic countries have not had a litigation-based legal system, and it may be difficult to develop the courts to meet these requirements. For example, general courts may lack the required routines or expertise in corporate matters. However, there may be other mechanisms available for overcoming the coordination problems of minority shareholders.

For enforcement mechanisms to be effective and relevant, they must take minority coordination problems into account and provide instruments that improve the position of minority shareholders without allowing for opportunistic behavior. Such enforcement mechanisms could include the possibility of class action law suits, for example, or specialized tribunals or courts where the cost risks of litigation are appropriately addressed. Additional mechanisms include, of course, enforcement by public authorities, such as securities regulators and tax authorities.[156]

In fact, minority shareholders in the Nordic countries are indeed supported by certain public enforcement institutions. For example, mandatory bid requirements apply to listed companies based on securities laws. Thus, minority interests are monitored by the authorities supervising the financial markets at little cost to the shareholders. The same applies to disclosure obligations.

It should further be noted that in Finland the minority redemption process is a special statutory process regulated in the Companies Act, where the costs are generally carried by the party redeeming the shares.[157] This allows the minority to challenge the redemption price without exposure to significant legal costs. In Finland this possibility is routinely used by activist minority shareholders, who buy a small position, challenge the redemption price and demand coverage for legal costs, in connection with public takeovers. Nevertheless, the size of the transactions involved has been small enough to render these problems largely insignificant.

Moreover, in Finland a reversed burden of proof is applied in cases concerning related-party transactions between the company and board members or controlling shareholders. This can be seen as a step towards creating fiduciary duties for controlling shareholders and clearly provides further support for minority interests.

[156] *See* Djankov et al. (2008), *supra* note 71.
[157] Finnish Companies Act 18:8.

However, minority shareholders wishing to challenge corporate decisions breaching the principles of the equal treatment of shareholders generally have to rely on general courts. Finland and Sweden lack courts specialized in corporate affairs or special tribunals that could address corporate matters on an expedited basis. The Nordic countries also lack functioning class action systems. Moreover, the legal fees of the opposing side are generally borne by the losing party. Thus, minority shareholders face considerable risks when pursuing their interests through the courts.

Sweden has an established tradition of self-regulation in relation to public takeovers and the merger and acquisition of listed companies. For instance, the Swedish Takeover Panel has a long-held practice of issuing statements on proper procedures in change of control situations. The panel also has the right to grant exemptions from mandatory bid obligations. The panel structure has the potential to provide a monitoring mechanism that promotes minority interests and eases coordination problems. The panel is a specialized body that provides guidance on an expedited basis in a process tailored to corporate requirements, and it has made considerable contributions to the development of Swedish takeover markets and to minority interests. More recently, a takeover code and a takeover panel have also been established in Finland. The code is mainly a codification of best practices in takeover situations, compensating for the lack of regulatory guidance and legal precedent, while the role of the panel has remained very small.

It should be noted, however, that self-regulatory organs may well be established to protect the interests of incumbent constituencies, and may promote prevalent or even entrenched market practices. In this regard, these panels are not always an efficient mechanism for the protection of minority interests.

Based on the discussion above, this chapter includes scores for Finland and Sweden in the minority protection index (Annex). The scoring is only rudimentary and is intended to highlight the relative strengths of the Nordic corporate governance system, on the one hand, and the areas requiring improvement, on the other. It has been emphasized that not all corporate governance mechanisms are equally relevant and that care should be taken over the weight each is given in an index.[158] For example, from another index with a broader range of metrics, Bebchuk, Cohen & Ferrell find only a small number of measurement variables that are relevant for a dispersed ownership environment. Thus, it is far from clear that the more mechanisms there are, the better the quality of corporate governance will be. Consequently, in order to provide an example of how different measurement variables can be given different values depending on their relevance in a specific index, each metric in the minority protection index has been granted a value of one, except for the principle of equal treatment, which has been granted a value of two. The index also includes references to EU regulation, where relevant, to give an overview of where EU regulation has provided standards with which Nordic countries must comply, and to give some insight into the still fragmented nature of EU company law regulations.

V. CONCLUSIONS

There are valid reasons for questioning the use of a single yardstick for measuring the quality of corporate governance systems.[159] The appropriate governance structures depend on the context – including the structure of corporate ownership, the quality of legal institutions and

[158] Bebchuk, Cohen & Ferrell (2004), *supra* note 72, at 1-2.
[159] *See* Bebchuk & Hamdani (2009), *supra* note 2 and Bhagat et al (2008), *supra* note 6.

the broader institutional environment. However, this does not rule out the relevance of measuring how corporate governance systems address the potential for abuse in a specific environment. Separate indices may be called for, on the one hand, for the relationship between shareholders and management and, on the other, for the relationship between controlling and minority shareholders. Furthermore, additional indices could address the position of creditors and employees.[160]

The Nordic model of corporate governance has scored reasonably well in established corporate governance indices. However, some of these indices have been geared to an environment of dispersed ownership and have assessed factors that are irrelevant in the Nordics. Moreover, some of the indices specifically tailored to an environment of concentrated ownership also seem to miss some of the dynamic of corporate governance in this environment. It is unclear, for example, whether "voice" is a key mechanism for protecting the interests of minority shareholders or whether there might be more significant functional equivalents. Indeed, "voice" is only one mechanism among many others. Moreover, "voice" can also allow the minority to behave in an opportunistic manner in situations where a diversified minority and an undiversified large shareholder have different risk profiles.

Overall, the Nordic model provides a number of relevant and important corporate governance mechanisms that are well adapted to an environment of concentrated ownership. The administrative powers of general meetings of shareholders allow for the effective monitoring of management by large shareholders, and equal treatment requirements and exit rules provide for a level of minority protection that seems to have resulted in low levels of private benefits of control. The Nordic countries also have some mechanisms for inducing the transfer of control when such transfer is called for, including favorable tax treatment for certain large shareholders when divesting their holdings. On the other hand, the Nordic countries also have tax systems which favor block-holding – thus providing an incentive for maintaining controlling positions.

With regard to the enforcement of minority rights, there are elements in the Nordic model that facilitate minority interests. In relation to redemption rights, for example, Finnish and Swedish company law provides for a statutory arbitration process when a majority shareholder with over 90 percent of the shares and votes in a company wants to redeem the remaining shares. In Finland, the same process is also used for mergers and demergers where minority shareholders opposing the transaction require redemption. Furthermore, mandatory bid situations are subject to securities regulation and are enforced by financial regulators. The same applies to the disclosure of related-party transactions.

However, certain key parameters of company law remain within the jurisdiction of the general courts. For example, the equal treatment of shareholders provides a basis for ensuring that private benefits of control are not extracted. However, equal treatment principles are generic standards that are assessed ex post by general courts. Minority shareholders face considerable coordination problems in pursuing their interests through the court system, as diversified minority shareholders with limited financial interests carry the full risk of unsuccessful litigation. Moreover, a court system with lengthy proceedings and a lack of specialization in corporate matters is an unsatisfactory dispute resolution mechanism for corporate matters.

[160] Pistor (2000), *supra* note 75, at 79.

An important corporate governance measurement variable would be the availability of a specialized dispute resolution system or agency for the promotion of minority interests. In line with the Nordic tradition, one could even consider the establishment of a minority shareholder ombudsman. An ombudsman could pursue minority shareholder interests and draw attention to practices, established or otherwise, that may be problematic from the perspective of the equal treatment of shareholders. An ombudsman's office does not necessarily require establishment by public authorities; rather, it could be an office set up by the stock exchange or minority shareholder interest groups. For example, in Sweden small shareholders are represented by a vocal interest group; however,it is unclear to what extent their actions are driven by an analytical approach to minority coordination problems rather than populist agendas.

The informal institutions identified in a number of studies as explanations for the quality of the Nordic model of corporate governance are not unimportant.[161] Reputational issues and other non-pecuniary benefits of ownership may certainly affect corporate governance.[162] However, the underlying reasons and drivers for such informal institutions may still warrant further analysis for a better understanding of their relevance and effect. It is also unclear whether they are effective in such circumstances as takeovers or other end-game situations. Moreover, it may be difficult to develop mechanisms for minority shareholders to take advantage of these informal institutions in specific situations.

Corporate governance systems can, in fact, also be analyzed from the perspective of political economy, which provides the framework for possible corporate governance solutions. The Nordic environment, to an important extent, has been defined by the dynamics of small economies with export driven industries,[163] where only limited private benefits have been available and where globalization has had a significant effect on the development of corporate governance.[164] The basic structure of concentrated ownership remains intact – with its associated control enhancing mechanisms and other complementary institutions. Nevertheless, at the same time increasing international investment and changes in the political economy have increased requirements for low levels of private benefits of control and a high level of minority protection.[165] The political economy also provides the framework for possible regulatory responses to the current corporate governance model. As discussed earlier, intervention in the control rights of controlling shareholders may be inappropriate in this environment. However, increased transparency requirements, for example, would be a good fit for this model. Moreover, there are unlikely to be fundamental problems in introducing more specialized dispute resolution mechanisms for corporate matters, or in otherwise facilitating the ability of minority shareholders to enforce their cash-flow and exit rights and monitor the actions of the controlling shareholder based on the equal rights of shareholders.

---

[161] *See* Sinani et al. (2008), *supra* note 135.

[162] *See* Jonas Agnblad, Erik Berglöf, Peter Högfeldt & Helena Svancar*, Ownership and Control in Sweden: Strong Owners, Weak Minorities, and Social Control*, 228, in THE CONTROL OF CORPORATE EUROPE (Fabrizio Barca & Marco Becht, Eds., 2002).

[163] *See* Timo Korkeamäki, Yrjö Koskinen & Tuomas Takalo, *Phoenix Rising: Legal Reforms and Changes in Valuations in Finland During the Economic Crisis* 29 (Bank of Finland Research Discussion Papers, 2007), *available at* http://www.suomenpankki.fi/en.julkaisut/tutkimukset/keskustelualoitteet/Documents/0701netti.pdf.

[164] Karl-Oskar Lindgren, *The Variety of Capitalism in Sweden and Finland* in THE CHANGING POLITICAL ECONOMY OF SMALL WEST EUROPEAN COUNTRIES 45, 56-57 (Uwe Becker, ed., 2011).

[165] See Korkeamäki et al (2007), supra note 163, and Ari Hyytinen, Ilkka Kuosa&Tuomas Takalo, *Law or Finance: Evidence from Finland* 30 (ETLA Discussion Paper No. 775, (2001), available at http://hdl.handle.net/10419/63926.

The characteristics of good corporate governance vary depending on the institutional environment. This creates challenges for the introduction of supranational regulation, where the same regulatory framework is applied in jurisdictions with different structures of corporate ownership and legal institutions of varying quality and character.[166] Developing legal strategies for EU-level regulation of corporate governance remains challenging in this regard, as the same mechanisms can have different – even contradictory – results in different institutional environments.[167] Efforts should be made to ensure that regulatory mechanisms are introduced that are tailored to the relevant environment. Furthermore, in planning regulatory intervention and in choosing legal strategies more attention should be paid to functionally equivalent regulatory mechanisms. The assessment of the quality of corporate governance throughout the EU is an important factor for planning regulatory intervention. Developing representative metrics for different types of corporate governance environment provides a basis for such assessments.

[166] ANDREW JOHNSTON, EC REGULATION OF CORPORATE GOVERNANCE, 144-146 (2010).
[167] *See* Coates (2003), *supra* note 29.

ANNEX

MINORITY PROTECTION INDEX FOR CONCENTRATED OWNERSHIP		
Mechanism	**Country/availability**	**Score**
Availability of mechanisms to restrict private benefits of control		
Disclosure obligations regarding block-holding positions	*Finland:* Disclosure requirements apply at set intervals from 5% of shares and votes in a listed company *Sweden:* Disclosure requirements apply at set intervals from 5% of shares and votes in a listed company *EU Regulation:* Disclosure requirements apply at intervals that can be set nationally but that must start at 5% of shares and votes in a listed company (Transparency Directive)	Finland: 1/1 Sweden: 1/1
Disclosure obligations regarding related party transactions	*Finland:* IFRS rules on related party transactions applied, but according to the FFSA compliance unsatisfactory; new rules being introduced in the Finnish CG Code; Special audit can be required by a 10 percent minority. *Sweden:* IFRS rules applied; Swedish Securities Council guidance requires that significant related party transactions must be disclosed. Special audit can be required by a 10 percent minority, or with the support of 1/3 of votes at a general meeting. *EU Regulation:* IFRS rules applied to listed companies. Special audit can be required by 10 percent minority. Disclosures rules on related-party transactions proposed through amendments to the SHRD. Disclosure of any "special advantage" granted to founders of a company required under the 2nd Company Law Directive.	Finland: 0.5 / 1 Sweden: 1/1
Procedural requirements	*Finland:* Amendments proposed to Finnish CG	Finland 0/1

for related-party transactions (third party approval or assessment; not necessarily by minority shareholders)	Code whereby listed companies shall apply procedures required for related-party transactions. *Sweden;* Significant related-party transactions are subject to general meeting authorization, where the votes of a related party (including a controlling shareholder) are not taken into account. *EU Regulation:* Proposal for amendments to the SHRD to introduce procedural requirements for related-party transactions	Sweden 1/1
Equal rights of shareholders (providing the legal basis for preventing private benefits of control or disenfranchisement of minority shareholders)	*Finland;* Provisions included in the Companies Act (general standard only). *Sweden:* Provisions included in the Companies Act (ABL 4:2, 7:47 and 8:41); (general standard only). *EU Regulation:* Principle of equal treatment adopted in Second Company Law Directive (Art. 46) and in the SHRD (Art. 4)	Finland: 2/2 Sweden: 2/2
Requirement for independent directors or similar minority representatives	*Finland:* Majority of board members in listed companies to be independent of the company and two of these also independent of large shareholders (based on CG Code on a comply-or-explain basis) *Sweden:* Majority of board members in listed companies to be independent of the company and two of them also independent of large shareholders (based on CG Code on a comply-or-explain basis) *EU Regulation:* No requirements	Finland: 0.5 / 1 Sweden: 0.5 / 1
Availability of mechanisms to protect cash-flow rights		
Qualified majority requirements for key corporate decisions (mergers, change of articles, deviation from pre-emption rights)	*Finland:* qualified majority requirements apply (in mergers majority to be obtained in each share class) Sweden; qualified majority requirements apply (in mergers majority to be obtained in each share class) *EU Regulation:* Qualified majority requirements apply (in mergers majority to be obtained in each share class; (Art 7 of the Merger Directive); decisions on certain capital measures are subject to qualified majority	Finland 1/1 Sweden 1/1

	support (Second Company Law Directive, Art. 44)	
Minimum dividend right	*Finland:* Shareholders representing 1/10 of shares can require a minimum dividend (OYL 13:7). However, there are no protective provisions on the calculation of distributable amounts. *Sweden:* Shareholders representing 1/10 of shares can require a minimum dividend (ABL 18:11). However, there are no protective provisions on the calculation of distributable amounts. *EU Regulation:* No EU-wide requirements	Finland 0.5/1 Sweden 0.5/1
Mechanisms allowing for redemption of minority shares (put and call) or offer at fair price at set level of ownership	*Finland:* redemption (put/call) at ownership exceeding 90 percent of shares and votes. *Sweden:* redemption (put/call) at ownership exceeding 90 percent of shares and votes. *EU Regulation:* redemption (put/call) at ownership exceeding 90–95 percent of shares and votes (Art 15 and 16 of the Takeover Directive)	Finland: 1/1 Sweden: 1/1
Mechanisms allowing for redemption of minority shares (put and call) or offer at fair price in significant transactions (mergers, demergers etc.)	*Finland:* redemption right for shareholders opposing mergers or demergers *Sweden:* no cash redemption right (cash-mergers prohibited – more than half of the consideration value shall consist of shares (ABL 23:2) *EU Regulation:* No redemption rights apply in mergers: the merger directive recognizes the possibility of redemption in national regulation (Art. 28 a).	Finland: 0.5 / 1 Sweden: 0 / 1
Mechanisms to induce voluntary transfer of control		
Neutral tax treatment for maintaining a set level of shareholding	*Finland:* Tax treatment of dividends favors pyramid holding structures (provided ultimate investment in listed company is over 10%) *Sweden:* Tax treatment of dividends favors pyramid holding structures (provided ultimate investment in listed company is over 10%) *EU Regulation:* N/A	Finland: 0/1 Sweden: 0/1

Neutral or favorable tax treatment for transferring control	*Finland:* Tax treatment favors sale of shares by large shareholders (sale is tax exempt if holding is over 10% and booked as fixed assets) *Sweden:* Tax treatment favors sale of shares by large shareholders (sale is tax exempt if holding is over 10% and booked as fixed assets) *EU Regulation:* N/A	Finland: 1/1 Sweden: 1/1
Exemptions available from mandatory bid requirements	*Finland:* Exemptions available, but practice is limited *Sweden:* Exemptions available and extensive number of precedents *EU Regulation:* Exemptions allowed provided certain principles are adhered to (TOD Article 4.5).	Finland: 1/1 Sweden: 1/1
Mechanisms to Facilitate Minority Coordination Problems for Effective Enforcement		
Entire fairness requirements and reversed burden of proof for related-party transactions (involving controlling shareholders)	*Finland:* reverse burden of proof applied to board members and controlling shareholders *Sweden:* no reverse burden of proof; but fairness opinions required (based on Swedish Securities Council Statement 2012:5) *EU Regulation:* arm's length requirements apply to certain related-party transactions (Second Company Law Directive Art 26)	Finland: 1/1 Sweden: 1/1
Availability of class action suits or other mechanisms to ease minority coordination problems (especially in cases related to enforcement of standards, such as the principle of the equal treatment of shareholders)	*Finland:* No class action; shareholders representing 10 percent of shares can sue on behalf of the company but risk bearing the full legal costs personally *Sweden:* No class action; shareholders representing 10 percent of shares can sue on behalf of the company but risk bearing the full legal costs personally. *EU Regulation:* No EU-wide rules.	Finland: 0/1 Sweden: 0/1
Special courts or tribunals for company law matters or agencies promoting minority interests (including takeover panels and special redemption	*Finland:* Special arbitration used for redemption proceedings; takeover panel established, but with very limited practice *Sweden:* Special arbitration used for redemption proceedings; takeover panel	Finland: 1/1 Sweden: 1/1

proceedings)	established, but with very limited practice *EU Regulation:* No EU-wide rules	
Public enforcement of securities laws (disclosure obligations, mandatory bid, if applicable, redemption price assessment)	*Finland:* Supervisory authority available to enforce mandatory bid rules and fair price provisions *Sweden:* Supervisory authority available to enforce mandatory bid rules and fair price provisions *EU Regulation:* A supervisory authority must be established (Takeover Directive, Art 4; Transparency Directive)	Finland: 1/1 Sweden: 1/1
Aggregate Score		**Finland: 12 / 17** **Sweden: 13 / 17**

CHAPTER 5

THE LAW AND POLITICS OF THE EU COMPANY LAW ACTION PLAN – TOWARD A FEDERAL SYSTEM OF CORPORATE GOVERNANCE REGULATION IN THE EU?

This chapter considers the law and politics of the EU Company Law Action Plan and considers resulting implications for adopting legal strategies for EU level corporate governance regulation. The study acknowledges that the EU institutions have an increased role in corporate matters after the financial crisis and that the EU is likely to remain an important source of corporate governance regulation. A key question is how this affects the interests of corporate constituencies and the political dynamics of corporate governance in the EU.

The chapter finds that the action plan has not introduced significant changes in the relative positions of corporate constituencies – despite the increased political salience of corporate governance. However, the action plan does reflect the trend towards centralization of regulation to larger political forums, and the decreasing scope for national regulation. The chapter argues that more emphasis is needed on the choice of appropriate legal strategies and on regulatory design sat the EU level that better facilitate diverse corporate governance models in the EU and that are tailored for different structures of corporate ownership and control.

I. INTRODUCTION: CONTROVERSY OVER THE COMPANY LAW ACTION PLAN

With its company law and corporate governance action plan published in 2012[1] the EU Commission has pursued a more interventionist policy with respect to corporate governance regulation than previously. The agenda for regulatory initiatives includes, among other, regulatory responses to perceived short-termism in the market, engagement of shareholders and better enforcement of corporate governance regulation[2]. Based on the Company Law Action Plan, the Commission has made detailed regulatory initiatives, including proposed amendments to the Shareholder Rights Directive[3].

The EU Commission's initiatives and the notion of increased EU level regulatory intervention in corporate governance have caused concern among key corporate constituents across the EU[4]. The initiatives have been argued to decrease the competitiveness of publicly listed

---

[1] *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Action Plan: European Company Law and Corporate Governance – a Modern Legal Framework for More Engaged Shareholders and Sustainable Companies,* COM(2012) 740/2 (Dec. 12, 2012) [hereinafter Company Law Action Plan].

[2] *Id.* at 3-5.

[3] *Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as Regards the Encouragement of Long-term Shareholder Engagement and Directive 2013/34/EU as Regards Certain Elements of the Corporate Governance Statement,* COM(2014) 213 final, 2014/0121 (COD) (Apr. 9, 2014).

[4] Nikki Tait, *Brussels Unveils Corporate Governance Plans*, FT, Apr. 5, 2011; Alison Smith & Nikki Tait, *Corporate Governance Divides Opinion*, FT, Apr. 21, 2011.

companies in the EU and consequently of the EU financial markets[5]. In responding to the initiatives, market participants have emphasized that corporate governance issues should be regulated primarily at the national level and that the EU should limit its involvement in this field[6]. Market participants have also expressed concern about the application of regulation related to social policies or external political interests to corporate governance matters specifically[7].

Considering the opposition to many of the proposals, it is unclear to what extent they will all be successfully implemented in the form initially contemplated by the Commission. Yet these initiatives, as such, are important in the context of the debate on the role of EU corporate governance regulation and emphasize the political aspects of corporate governance in the EU. It is important to understand the drivers underlying the Company Law Action Plan and the reasons for the EU Commission for seeking to increase its role in corporate governance regulation. This study adopts a political approach to EU regulatory initiatives, including the Company Law Action Plan and the Shareholder Rights Directive. The study considers the relationship between EU and national level corporate governance regulation in light of the trend towards more centralized sources of regulatory policy, including the EU, the G-20 and the OECD, that has emerged after the financial crisis[8]. In this regard the study will consider how a federal or multilevel structure of corporate governance regulation may evolve in the EU.

The chapter will be structured as follows. Section II will provide an overview of the debate on EU initiatives in the field of corporate governance, the dynamics of harmonization and regulatory competition, and the possible regulatory implications of the increased political salience of corporate governance at the EU level. Section III will then introduce the Company Law Action Plan from 2012 and certain regulatory instruments introduced pursuant thereto. The political dynamic of the Company Law Action Plan is discussed in section IV. Finally, the study considers the preconditions for the evolution of a federal or multilevel model of corporate governance regulation in the EU in section V.

II. CHALLENGES FOR INTRODUCING EFFECTIVE EU REGULATION

There has been much debate in Europe as to the proper role of the EU with respect to company law and corporate governance[9]. EU initiatives have been subject to considerable

---

[5] *Report of the Reflection Group on the Future of EU Company Law*, at 10, 2011, *available at* http://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en.pdf [hereinafter the EU Reflection Group Report].

[6] *See* Luca Enriquez & Matteo Gatti, *The Uneasy Case for Top-Down Corporate Law Harmonization in the European Union*, 27 U.PA.J.INT'L.ECON.L. 939 (2006).

[7] Massimo Belcredi & Guido Ferrarini, *Corporate Boards, Incentive Pay and Shareholder Activism in Europe: Main Issues and Policy Perspectives*, *in* BOARDS AND SHAREHOLDERS IN EUROPEAN LISTED COMPANIES 29 (Massimo Belcredi & Guido Ferrarini, eds., 2013).

[8] FINANCIAL REGULATION AND SUPERVISION, A POST-CRISIS ANALYSIS (Guido Ferrarini, Klaus Hopt & Eddy Wymeersch, eds., 2012), THE REGULATORY AFTERMATH OF THE GLOBAL FINANCIAL CRISIS (Elis Ferran, Jane Hill & John Coffee, eds., 2012), UNCTAD, CORPORATE GOVERNANCE IN THE WAKE OF THE FINANCIAL CRISIS, SELECTED INTERNATIONAL VIEWS (UNCTAD/DIAE/ED/2010/2), 2010.

[9] *See* John Armour, *Who Should Make Corporate Law? EC Legislation versus Regulatory Competition* (ECGI - Law Working Paper No. 54/2005), *available at* http://ssrn.com/abstract=860444 or http://dx.doi.org/10.2139/ssrn.860444; John Armour & Wolf-Georg Ringe, *European Company Law 1999-2010: Renaissance and Crisis* (ECGI – Law Working Paper No. 175/2011, Oxford Legal Studies Research Paper No. 63, 2010), *available at* ttp://ssrn.com/abstract=1691688 or http://dx.doi.org/10.2139/ssrn.1691688; Luca Enriques, *Company Law Harmonization Reconsidered: What Role for the EC* (ECGI Law Working Paper No 53,

criticism and the EU has even been deemed to have failed in its goal to develop competitive corporate governance regulation[10]. Enriquez & Gatti argue that it has not been demonstrated that the EU Commission is any better than national regulators in addressing market failure and that, in fact, EU initiatives have not lead to decreased transaction costs, but increased them as a result of the added complexity and uncertainty of national corporate laws resulting from the impact of EU regulation[11]. Many commentators and interest groups alike have argued that corporate law should be enacted at the national level and that any EU initiatives should be minimized and in any case limited to cross-border aspects of corporate action only[12]. National corporate law has been argued to include established elements that are specific to member states so that supranational intervention would disturb the evolved complementarities with existing economic structures[13].

It has proved challenging to introduce EU level regulation and regulatory outcomes have often been deemed unsatisfactory. It has been argued that even if the EU has issued a broad range of company law regulation, the real impact of EU company law has been limited. EU regulation has not really covered core areas of company law, such as fiduciary duties or remedies available to shareholders[14]. Instead, regulation has focused on technical areas, where national governments might have legislated even without EU intervention. Earlier integration efforts have been argued to have been rather limited in scope[15] while some of the more comprehensive reform initiatives in the 1990's failed in the face of significant political resistance[16]. All in all, the scope of company law harmonization has been fairly limited compared to capital markets regulation, for example, which may be more directly related to core EU policies (free movement of capital)[17].

The quality of regulatory outcomes of EU initiatives has also been subject to criticism. The enactment of efficient rules has been difficult, and political compromises have often been necessary. This has at times resulted in regulatory outcomes that have been argued to have been misguided and ineffective[18]. The impact of EU level corporate legal rules has been limited, for example, by the optionality sometimes provided in how the rules can be

---

2005), *available at* http://ssrn.com/abstract=850005; Enriques & Gatti (2006), *supra* note 6, Gerard Hertig & Joseph A. McCahery, *Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition?* (ECGI Law Working Paper No 12/2003), *available at* http://ssrn.com/abstract=438431.

[10] Enriques (2005), *supra* note 9, at 11.

[11] Enriquez & Gatti (2006), *supra* note 6, at 940.

[12] *See, inter alia,* Peter Böckli, Paul Davies, Eilis Ferran, Guido Ferrarini, José Garrido, Klaus Hopt, Alain Pietrancosta, Katharina Pistor, Rolf Skog, Stanislaw Soltysinski, Jaap Winter & Eddy Wymeersch, *European Company Law Experts, Response to the European Commission's Consultation on the Future of European Company Law*, 2012, 1-5, *available at* http://ssrn.com/abstract=2075034 [hereinafter Expert Report 2012].

[13] Armour & Ringe (2011), *supra* note 9, at 4 – 5.

[14] *See* Enriques (2005), supra note 9.

[15] *See* Luca Enriques, *EC Company Law Directives and Regulations: How Trivial Are They?*, 27 U.PA.J. INT'L.EC.L. 1 (2006).

[16] *See Proposal for a Fifth Directive on the Structure of Public Limited Companies and the Powers and Obligations of Their Organs,* COM(83) 185 final, 1983, OJ C240/2 [hereinafter the Fifth Company Law Directive Proposal].

[17] Armour & Ringe (2011), *supra* note 9, at 27.

[18] *See* Enriques & Gatti (2006) *supra* note 6.

implemented. This was the case in connection with the Takeover Directive[19], where some of the mechanisms introduced by the EU Commission were strongly opposed[20].

It has also been pointed out that EU level corporate regulation has been under-enforced[21]. The Commission is deemed to lack the resources to efficiently monitor compliance. Member states have at times also failed to introduce efficient sanctions regarding compliance with some of the EU initiated legal rules. The national implementation of EU corporate law has also been inconsistent, as rules have been adapted to local legal systems[22]. As a result of these shortcomings, it has been argued, EU corporate regulation has often been marginalized – even trivial[23].

The criticism seems to support the case for developing corporate governance regulation at the national level and relying on regulatory competition to promote better regulation and market integration. However, the dynamics of regulatory development are more complex, and it is not always clear that national regulation fares better in an increasingly international corporate environment. The Company Law Action Plan is based on the perception that the existing largely national regulatory frameworks regarding corporate governance in the EU member states have been inadequate for the purposes of appropriate monitoring of management and for sufficient investor protection[24]. While national systems of corporate governance are adapted to the existing institutional environment they may also reflect the entrenched interests of dominant corporate constituencies[25]. An emphasis on national level regulation can strengthen path dependence in regulation and serve to promote the national lock-in of corporate enterprise and weaken market integration[26]. Despite the observed challenges, then, EU level corporate governance regulation cannot so easily be dismissed.

A. HARMONIZATION VS. COMPETITION

The criticism of EU corporate governance regulation is closely related to the debate on whether harmonization or regulatory competition is the better avenue to pursue market integration in the European Union. Commentators have questioned the extent to which it is appropriate to introduce uniform EU level corporate governance regulation considering the variation in corporate environments through the EU member states[27]. The alternatives to harmonization include negative integration through the courts (i.e. enforcing the EU

---

[19] Directive 25/2004/EC of the European Parliament and of the Council of 21 April 2004 on Takeover Bids, 2004 O.J. (L142) [hereinafter Takeover Directive]; *see also* Thomas Papadopoulos, *The Mandatory Provisions of the EU Takeover Bid Directive and Their Deficiencies*, 1 LFMR 525-533 (2007).
[20] *See* Rolf Skog, *The Takeover Directive – an Endless Saga?*, 13 EUR. BUS. L. REV. 301-312 (2002).
[21] Enriques (2006), *supra* note 15, at 12-17.
[22] *Id.* at 50-55.
[23] *Id.* at 1.
[24] Company Law Action Plan, *supra* note 1, at 3-4.
[25] *See* Guido Ferrarini & Geoffrey P. Miller, *A Simple Theory of Takeover Regulation in the United States and Europe* (New York University Law and Economics Working Paper 197, 2009), *available at* http://lsr.nellco.org/nyu_lewp/197.
[26] ANDREW JOHNSTON, EC REGULATION OF CORPORATE GOVERNANCE 113-116 (2009); *see also* Enriques (2005), *supra* note 9, at 9-11 and Roger Van den Bergh, *Regulatory Competition or Harmonization of Laws? Guidelines for the European Regulator, in* THE ECONOMICS OF HARMONIZING EUROPEAN LAW (Alain Marciano & Jean-Michel Josselin, eds., 2002).
[27] *See* Enriquez & Gatti (2006), *supra* note 9.

freedoms) or leaving matters to be regulated at the national level and relying on regulatory competition to force competitive solutions to develop in the EU[28].

The reasons traditionally given for promoting harmonization are based on the recognition that a framework of common rules facilitates cross-border business and prevents distortions in the internal market based on differences in national laws[29]. Such differences increase transaction costs and legal uncertainty, which hinders the free movement of capital and the freedom of establishment. If legal protections are different, investors may be reluctant to make cross-border investments, for example. Differences in national laws can also cause distortions in the form of costs from different minimum capital and disclosure rules, among other. These differences can have an unwarranted effect on the legal form of enterprise in cross-border situations.

There are equally convincing arguments supporting a policy of regulatory competition, however. As corporate constituencies are able to choose among different jurisdictions, the most competitive regulatory environment will attract more interest and persist. Different types of regulatory requirements can also better be met as corporations or businesses with different characteristics can choose the regulatory environment that best fits their needs. Further, allowing national regulation to develop provides the opportunity to test different regulatory approaches, while harmonization leads to a monopoly of regulation with resulting inefficiencies[30].

At the EU level, national courts and the European Court of Justice (the "ECJ") can intervene in national measures that contravene the EU treaty freedoms, including the freedom of establishment, without positive harmonization. In this regard it can be noted that as EU level legislative processes stalled due to political differences in relation to the development of EU level company law, rulings of the ECJ have promoted further market integration[31]. In the context of corporate law, several landmark judgments on the freedom of establishment from the *Centros*-case in 1999[32] to the more recent *Vela* case decided in 2012[33] have slowly paved the way for regulatory competition within the EU. With ECJ judgments supporting negative harmonization by developing the freedom of establishment for corporations in the EU, regulatory competition has often been argued to be a superior mechanism for developing corporate governance in the EU[34].

---

[28] *For a discussion, see* Johnston (2009), *supra* note 26, at 146-213.
[29] *See* Christiaan Timmermans, *Harmonization in the Future of Company Law in Europe*, *in* CAPITAL MARKETS AND COMPANY LAW 628 (Klaus Hopt & Eddy Wymeersch, eds., 2003).
[30] Enriquez (2005), *supra* note 9, at 2.
[31] Johnston (2009), *supra* note 26, at 146.
[32] Case C-212/97, Centros Ltd v Erhvervs- og Selskabsstyrelsen [1999] ECR I-1459; the establishment of a company in the UK for the purposes of the setting up branches in Denmark was argued to be abuse of the freedom of establishment. the ECJ stated (para. 27) that "the fact that a national of a Member State who wishes to set up a company chooses to form it in the Member State who rules of company law seem to him the least restrictive and to set up branches in other Member States cannot, in itself, constitute an abuse of the right of establishment."
[33] Case C-378/10 VALE Építési kft. [2012] ECR 00000; the question related to the possibility of a company established in a Member State to convert into a company established under foreign law. The ECJ confirmed that if the host state allows for conversion as such, then "the refusal by the authorities of a Member State, in relation to a cross-border conversion, to record in the commercial register the company of the Member State of origin as the 'predecessor in law' to the converted company is not compatible with the principle of equivalence if, in relation to the registration of domestic conversions, such a record is made of the predecessor company."
[34] *See* Enriques & Gatti (2006), supra note 6.

There has been some concern, however, that regulatory competition could lead to a "race to the bottom" where EU member states would develop regimes that cater to select interest groups and that may disenfranchise different corporate stakeholders, such as minority shareholders or employees[35]. In other words, national regulation would result in externalities with effects outside the relevant jurisdiction that would not be "fixed" by regulatory competition. Reference has been made to the emergence of a "European Delaware" in this respect[36]. It has been argued that the corporate constituency with the authority or possibility to affect re-establishment or incorporation decisions would receive favored treatment, and that Delaware law, for example, can be seen to favor management over shareholders in this regard[37]. Corporate ownership remains more concentrated in the EU than in the United States, and it would likely be controlling shareholders who would be in the position to pursue such decisions. Thus, in the EU, there might be concern that minority protections, creditor protection or labor interests would be affected by re-incorporations[38]. There have been some signs of companies being incorporated in the UK due to low capital requirements or in order to avoid codetermination regulation, for example[39].

The prerequisites for effective real-world regulatory competition have also been debated[40]. Regulation is only one factor affecting companies, and benefits from regulatory arbitrage in the field of corporate law or corporate governance may not be significant enough to cover costs of relocation. Taxation has typically been a more dominant feature in this regard. It is also not clear whether EU member states would, in fact, have sufficient incentives to develop policies with the specific aim of attracting companies to re-establish in their jurisdictions. In the United States, it seems that Delaware has become the predominant jurisdiction for incorporation and that other states lack incentives to attract new incorporations[41]. It has been argued that in the EU there would similarly be lack of incentives for member states to supply regulation tailored to attract corporate incorporations[42]. Benefits may be limited, risky and long-term, while the investments required would be immediate and costly. Moreover, franchise taxes are generally prohibited in the EU, except where the company has its real seat, and companies are otherwise generally taxed where operations take place[43]. There is also a risk for political repercussions at the EU level for an active policy of attracting incorporations at the cost of other EU member states.

In the EU, considerable national lock-ins remain for corporations subject to a plethora of regulation varying from labor regulation to taxation, which hinder efficient cross-border establishment. Also, the differences in the institutional environments (including

[35] *See* Johnston (2009), *supra* note 26, at 123-124.
[36] *Id.*
[37] *See* Lucian A Bebchuk & Assaf Hamdani, *Federal Corporate Law: Lessons from History* (Harvard Law School John M. Olin Center of Law, Economics and Business Discussion Paper Series 558, 2006), *available at* http://lsr.nellco.org/harvard_olin.
[38] Johnston (2009), *supra* note 26, at 124.
[39] *See* John Armour, *Who Should Make Corporate Law? EC Legislation Versus regulatory Competition* (ESRC Centre for Business Research, University of Cambridge Working Paper No. 307, 2005), *available at* http://www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working-papers/wp307.pdf.
[40] Johnston (2009), supra note 26, at 176-184.
[41] *See* Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679 (2002); Marcel Kahan, *The State of State Competition for Incorporations* (ECGIW Law Working Paper 263, 2014), *available at* http://ssrn.com/abstract=2474658.
[42] Johnston (2009), *supra* note 26, at 182.
[43] *Id.*

complementary institutional structures) do not necessarily facilitate an expedited process of regulatory competition. Altogether, there is some concern that the premises for regulatory competition in the EU are still incomplete, and cannot necessarily be relied on to provide a mechanism for EU wide regulatory development. Also, negative harmonization based on court rulings and interpretations of the EC Treaties is often argued to be too slow to support efficient market integration. Thus positive harmonization may remain a relevant avenue for pursuing EU policies in the field of company law for the time being.

B. Corporate Governance and Perceived Differences in Economic Systems in the EU

The differences in economic systems that are deemed to prevail in the EU pose an extra challenge for introducing uniform EU regulation in the field of corporate law. The effects of EU level regulatory intervention may differ among the member states depending on the institutional environment, which does not facilitate the creation of a level playing field. Institutions develop to complement existing features of the corporate environment[44]. In this type of environment the introduction of supranational rules can have very different and unintended consequences[45]. For example, corporate governance mechanisms that are relevant in the context of dispersed ownership may not be meaningful or effective in a concentrated ownership environment, where the relevant regulatory concerns are completely different. The effects of regulation can also depend on the availability of enforcement systems, such as court systems or agencies, where the quality of the relevant institutions across the EU can vary considerably[46]. It has been argued, for example, that the introduction of a mandatory break-through rule in the Takeover Directive would, in reality, likely not have facilitated challenging the control of large shareholders but lead to the further increase in the concentration of ownership and control as owners would have reacted to the new regulation[47].

The relevant institutional environment affects initial choices of corporate ownership structure that tend to be path dependent explaining why different structures of corporate ownership and different corporate governance systems persist. When a given structure of corporate governance has been established, it is likely to be reinforced[48]. Bebchuk & Roe[49] suggest that sunk costs, externalities and complementarities caused by initial choices increase the cost of alternative structures. Existing structures may also persist due to rent-seeking by controlling constituencies. The regulatory framework can be seen as a complementary institution that recognizes and reinforces certain ownership structures both due to efficiency and rent-seeking. The entrenchment of corporate control is often a distinctive feature in corporate

---

[44] *See* Lucian A. Bebchuk and Mark J. Roe, *A Theory of Path Dependence in Corporate Governance and Ownership*, 52 STAN. L. REV. 127 (1999).

[45] *See* Marc Goergen, *What Do We Know about Different Systems of Corporate Governance?* (ECGI Finance Working Paper 163, 2007), *available at* http://ssrn.com/abstract_id=981531; *see also* Johnston (2009), *supra* note 26, at 181.

[46] *See EU Commission, Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States,* Sept. 23, 2009, *available at* http://ec.europa.eu/internal_market/company/docs/ecgforum/studies/comply-or-explain-090923_en.pdf; *see also European Commission Green Paper, Building a Capital Markets Union*, COM(2015) 63 final, at 9 and 24-25, Feb. 16, 2015.

[47] John C. Coates IV*, Ownership, Takeovers and EU Law: How Contestable Should EU Corporations Be?* 12 (ECGI Law Working Paper 11/2003), *available at* http://ssrn.com/abstract=424720.

[48] *See* DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE (1990).

[49] *See* Bebchuk & Roe (1999), *supra* note 44.

governance[50]. Addressing this issue through regulatory intervention might be challenging regardless of the structure of ownership. The self-reinforcing nature of the structure of corporate ownership and its relationship to the applicable regulatory framework is important to recognize in initiatives to develop corporate governance regulation.

The effects of the potential entrenchment of control are important to consider in connection with corporate governance regulation. It has been argued that change is a pervasive characteristic of the interaction between economic, political and corporate environments[51]. Technological changes affect the business and organizational environments of corporations, and it is vital that the organizational structures of business can be adapted to changing circumstances. Regulation should facilitate the possibilities of corporate enterprise to adapt to changes in their environments. At the same time, as discussed above, entrenchment of control has often been seen as a factor in any corporate governance system[52]. Regulatory models are needed to counter entrenchment and to facilitate corporate acquisitions and the transfer of control, for example. As regards the EU, this may be a challenge distinctive to national regulatory systems where regulation may have been entrenched to the benefit of dominant corporate constituencies. Representing a broader variety of corporate systems, the EU may well have a legitimate role as the source for regulatory initiatives as national governance systems have shown signs of further consolidating existing control structures[53].

This discussion emphasizes the importance of addressing corporate governance issues in the context of existing structures of ownership and control. It is important, regardless of the source of regulation, be it national or supranational, that corporate governance regulation be adapted to the characteristics of the relevant institutional environment. This does not mean that EU level regulation would be suboptimal as such, or that national level regulation is *per se* superior, but only that regulatory mechanisms should be better adapted to the prevailing institutional environment. EU level legal strategies should not disenfranchise specific forms of ownership or governance but, instead, seek to address the potential for abuse within existing governance structures. It is important to identify the relevant relationships that are vulnerable to abuse and then to apply appropriate legal strategies tailored to the institutional environment.

C. A POLITICAL APPROACH TO EU CORPORATE GOVERNANCE REGULATION

Regulation can be seen as the outcome of the interaction between political and market structures, reflecting the impact of interested market participants and the political environment[54]. Changes in regulation can be seen to reflect changes in the relative bargaining power of these constituencies. The political economy sets out the broader parameters for feasible regulatory outcomes. Within these parameters, the public choice literature identifies a

---

[50] *See* ALESSIO M. PACCES, RETHINKNG CORPORATE GOVERNANCE – THE LAW AND ECONOMICS OF CONTROL POWERS 14, 411-413 (2012).
[51] Ronald J. Gilson, *The Political Ecology of Takeovers: Thoughts on Harmonization of the European Corporate Governance Environment*, 61 FORDHAM L. REV. 161, 175 (1992).
[52] Pacces (2012), *supra* note 50.
[53] *See* Guido Ferrarini & Geoffrey P. Miller, *A Simple Theory of Takeover Regulation in the United States and Europe* (New York University Law and Economics Working Paper 197, 2009), *available at* http://lsr.nellco.org/nyu_lewp/197; *see also* Van den Bergh (2002), *supra* note 26.
[54] *See* Mark Roe: *Political Preconditions to Separating Ownership from Corporate Control*, 53 STAN.L.REV. 539 (2000); *see also* MARK ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE (2003).

"market for regulation" where regulatory changes are the result of bargaining among relevant constituencies, including market participants, regulatory agencies and politicians[55].

Politics and corporate governance systems are interlinked[56]. Corporations and the way they are governed are of considerable economic importance. Corporate governance has a significant effect on the preconditions for the creation of wealth and economic growth, as well as on the distribution of the cash flows and profits from corporate enterprise. It is natural that corporate governance should have considerable political implications as key corporate constituencies agree and renegotiate their relationships through the political framework[57]. Corporate constituencies are also interest groups that can use political means to further their own interests. In fact, a two-way causation has been identified between the two so that politics and corporate governance can be said to co-evolve[58]. Different political conditions impact the structure of corporate governance systems, while different corporate governance systems can similarly cause different political reactions[59].

Promoting the Interests of Corporate Constituencies

The political economy of corporate governance is generally analysed in relation to how the respective interests of different corporate constituencies are balanced in relative terms. Shareholders, management and employees are often identified as the main corporate constituencies in this regard. Creditors and increasingly, with the increasing political interest in corporations, tax payers at large are other groups with interests in corporate governance that they enforce through policy decisions and regulation. Depending on the structure of the economy and the political system different constituencies may have different bargaining power resulting in a variety of corporate governance models – some reflecting the pre-eminence of shareholder interests and others the more continental structure reflecting labour and creditor interests, for example.

The ability of different constituencies to promote their own interests can vary. Olson[60] argues that smaller interest groups with homogenous interests will overcome coordination problems and be able to protect their interests in a satisfactory way. Large interests groups with similar interests can be expected to pursue their interest directly through the political system. Labor interests, for example, can be expected to be reflected in this way. On the other hand, large interest groups with dissimilar interests may not be able to coordinate their action in specific issues. With respect to corporate governance minority shareholders may be a group with some difficulty in overcoming coordination problems. Minority shareholders may have diverging agendas and may not have sufficient financial interests involved to allow for efficient political cooperation. Based on Olson's arguments, minority shareholders may be the group that would not be in the best position to coordinate activities at the political level with respect to corporate governance or takeover regulation. The interests of these constituencies, then, may

[55] *See* George Stigler, *The Theory of Economic Regulation*, 6 BELL J. OF ECON. 2, 3-21 (1971); Samuel Peltzman, *The Economic Theory of Regulation After a Decade of Deregulation* 13 (Brookings Papers on Economic Activity, 1989).
[56] *See* Marianna Belloc & Ugo Pagano, *Politics-Business Co-Evolution Paths: Workers' Organization and Capitalist Concentration*, 33 INT.L. REV. OF L. AND ECON. 23 (2013); see also Ugo Pagano, *The Evolution of the American Corporation and Global Organizational Biodiversity*, 35 SEATTLE U. L. R. 1271, 1272 (2012).
[57] *See* Roe (2000), *supra* note 54, Roe (2003), *supra* note 54.
[58] Pagano (2012), *supra* note 56, at 1272.
[59] *Id.*
[60] *See* MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION (2ND ED., 1971).

require specific attention from regulators if market based regulation and investor protection are desired.

With respect to corporate governance and investor protection in general, corporate insiders, entrepreneurs and institutional investors have been identified as relevant interest groups that can affect regulation, while outside investors have been deemed a group too dispersed to be able to be an effective coordinated group for the purposes of affecting regulation[61]. Bebchuk & Neeman argue that corporate insiders can capture the full benefits of any changes to regulation and as they can, to some extent, use corporate funds to affect such changes, they are willing to invest fully in lobbying activity. At the same time, institutional investors will have the burden of being able to capture only part of such benefits as any benefits they obtain will also benefit other investors[62]. Entrepreneurs are argued to opt for a balance in investor protection that supports raising capital. This imbalance is deemed likely to tilt corporate governance regulation to the benefit of corporate insiders and entrepreneurs[63]. This suggests, in line with Olson, that the interests of outside investors may require regulatory attention.

Political economies are sufficiently complex so that they are rarely dominated by single political interests. In other words, a single constituency is rarely in the position to dictate policy. Gourevitch & Shinn have assessed the potential for political coalitions between different corporate key constituencies[64]. Different constituencies can seek to bargain with each other, or if interests are not sufficiently uniform within a group, their political influence can be divided. For example, employees and managers may cooperate to promote stability, the size of the corporation and insiders' claims on corporate income[65]. On the other hand, the industrial dynamic may also encourage shareholders and employees to combine their interests to constrain managerial agency costs[66].

A factor further increasing the complexity of these relationships is the development of the ownership landscape and the institutionalization of shareholding[67]. Shares are often mainly held through intermediaries that have independent interests that may or may not be aligned with those of beneficial owners. Where ultimate shareholders may have long-term investment horizons, intermediaries may have short-term interests related to their compensation systems[68], for example. They may thus support and encourage short-term policies[69]. This has been a concern raised by the EU Commission in the context of the Company Law Action Plan as well. There are concerns that the different time-horizons of investors and their representatives give rise to a set of horizontal conflicts among shareholders, and that

---

[61] *See* Lucian A. Bebchuk & Zvika Neeman, *Investor Protection and Interest Group Politics* (John M. Olin Center Program on Corporate Governance Discussion Paper 603, 2007), *available at* http://ssrn.com/abstract=1030355.

[62] *Id.* at 3-7.

[63] *Id.*

[64] PETER GOUREVITCH & JAMES SHINN, POLITICAL POWER AND CORPORATE CONTROL 60-68 (2005).

[65] *See* Marco Pagano & Paolo Volpin, *The Political Economy of Corporate Governance* (Centre for Economic Policy Research Discussion Paper No. 2682, 2001), *available at* http://www.csef.it/pagano/AER-2005.pdf.

[66] Gourevitch & Shinn (2005), *supra* note 64.

[67] Usha Rodriques, *Corporate Governance in an Age of Separation of Ownership from Ownership*, 95 MINN. L.REV. 1822, 1828 (2011).

[68] Christoph van der Elst & Erik Vermeulen, *Europe's Corporate Governance Green Paper: Do Institutional Investors Matter?* 6 (Tilburg Law School Legal Studies Research Paper Series 14, 2011), available at http://ssrn.com/abstract=1860144.

[69] Rodrigues (2011), *supra* note 67, at 1829.

empowering shareholders in these circumstances may lead to increased "short-termism"[70]. However, it is possible that while investors may have long-term interests, they are indifferent to how these goals are achieved and may well prefer a series of short-term investments in a diversified portfolio. In any case, it is argued, there should be more transparency with regard to the policies pursued by these intermediaries[71].

In studying the development of corporate governance regulation it is possible to look at how regulatory initiatives affect the current interests of corporate constituencies. Thus, to better understand the development of EU level corporate governance regulation, and of the significance of the Company Law Action Plan, for example, it is important to look at how the action plan initiatives could affect the interests of key corporate constituencies. Considering the concern caused by the Company Law Action Plan among certain key interest groups, it is interesting to analyse whether the action plan could reflect a political shift in EU level corporate governance regulation.

The Market for Regulation at the National and International Levels

The public choice literature recognizes that regulation can generally be deemed to reflect the interests of dominant interest groups or political coalitions. The dynamics of the market for regulation may differ at the national and international levels; the ability of interest groups to organize and to affect regulation may be different at the national than at the international level, for example. Also, the introduction of supranational regulation as a partially parallel regulatory framework makes the regulatory dynamic far more complex.

The introduction of the EU framework has established a parallel regulatory framework to national regulation. Constituencies can pursue regulatory agendas through both the national and the EU regulatory frameworks[72]. The preference for regulatory competition (national regulation) or harmonization (EU regulation) may also be driven by how the relevant constituency can best promote its interests in relation to other constituencies. Constituencies with considerable sunk costs and a high threshold for corporate mobility may not be able to take advantage of the freedom of establishment. To prevent competitors from taking advantage of more competitive regimes they would opt for EU level harmonization setting similar rules throughout the EU that would cater to existing industrial structures. Constituencies with lower costs for relocating, on the other hand, will lobby for national regulation and regulatory competition, as they can move their operations to jurisdictions with more favourable regulation, for example[73].

An important element in the ability of interests groups to pursue their interests is that the dynamics of the market for regulation may be different at the national and international levels. The ability of interest groups to coordinate their action may be different at the national and international levels. Certain interest groups may have significant influence on regulation at the national level, while their ability to influence EU level regulation can be limited. Ferrarini

70 Company Law Action Plan, *supra* note 1, at 5 and 9.
71 *Id.*
72 *See* Helen Callaghan, *How Multilevel Governance Affects the Clash of Capitalisms* (MPIfG Discussion Paper 08/5, 2008), available at www.mpifg.de (publications, discussion papers).
73 *See* Jeanne-May Sun & Jacques Pelkmans, *Regulatory Competition in the Single Market*, 33 J. OF COMMON MARKET STUDIES 67 (1995).

& Miller argue that the interests of corporate insiders remain strong at the national level[74]. With respect to takeovers, for example, target company interests may have more influence at the level of national regulation than the interests of bidders. At the domestic level, interest groups representing management, labour and community groups are likely to advocate for rules that increase the threshold for takeovers[75]. At the international (or federal) level, however, the influence of these interest groups may be more balanced[76]. Corporate insiders may not have the same relative advantage over the interests of bidders (and minority shareholders) who may better be able to organize themselves on an international basis.

The concerns identified above have some support in findings from the United States. In analyzing the development of state corporate regulation, Bebchuk & Hamdani find that states have generally favored corporate insiders whereas federal regulation has more consistently favored external investors and minority shareholders[77]. The authors argue, in line with Ferrarini & Miller, that corporate insiders do not have the same political influence at the federal level and that other constituencies are better able to cooperate at this level of regulation – possible due to economies of scale. In a long-term empirical analysis, Cheffins, Bank & Wells support this view and argue that U.S. federal regulation has played a crucial role in enhancing shareholder rights[78].

The political dynamics of supranational regulation are more complex than with regard to regulation at the national level. At the EU level it may be more difficult for individual interest group to promote their interests by affecting EU policies and regulations, for example. The EU provides an alternative and parallel framework for pursuing interests through the political system resulting in a system of multilevel governance that may be less prone to be dominated by specific policies. The EU institutional set-up allows for competing political coalitions to simultaneously advance different reforms thus limiting the possibility for interest groups to monopolize policy[79]. Callaghan, for example, argues that the multilevel system established with the introduction of the EU framework increases strategic opportunities for using regulation to pursue policies across the EU – regardless of the national system of corporate governance[80]. Also, the institutional set-up of the EU allows different types of policies to be pursued simultaneously. In other words, it is not as easy for a single interest group (or coalition) to dominate the political agendas regarding a particular field of regulation. This can result in reforms reflecting, at the same time, different policies[81].

In an EU context it is also possible that benefits of regulation are not evenly distributed. Market actors in jurisdictions with a favourable institutional environment may have an advantage over actors in other jurisdictions. When markets are being opened through EU regulation, some will be better positioned than others to take advantage of the new situation.

---

[74] *See* Guido Ferrarini & Geoffrey P. Miller, *A Simple Theory of Takeover Regulation in the United States and Europe* 15 (New York University Law and Economics Working Paper 197, 2009), *available at* http://lsr.nellco.org/nyu_lewp/197.
[75] *See* Roberta Romano, *The Political Economy of Takeover Statutes*, 112 VIRGINIA L.R. 111 (1987).
[76] *See* Ferrarini & Miller (2009), *supra* note 74.
[77] See Lucian A. Bebchuk & Assaf Hamdani, *Federal Corporate Law: Lessons from History* (HLS John M. Olin Center Discussion Paper Series, 2006), *available at* http://lsr.nellco.org/harvard_olin.
[78] See Brian R. Cheffins, Steven A. Bank & Harwell Wells, *The Race to the Bottom Recalculated: Scoring Corporate Law Over Time* (ECGI Law Working Paper 261, 2014), *available at* http://ssrn.com/abstract_id=2475242.
[79] *Id.* at 10.
[80] *See* Callaghan (2008), *supra* note 72.
[81] *Id.*

The Political Salience of Corporate Governance

It is important to note that the different regulatory approaches to developing corporate governance regulation in the EU – harmonization and regulatory competition –have significant political implications. The different approaches are linked to expected regulatory outcomes and reflect underlying political preferences. The dynamics of positive and negative integration also differ. Negative integration and regulatory competition are often associated with a market oriented or laissez-faire approach to corporate regulation[82]. Generally negative integration limited to enforcing treaty freedoms would result in deregulation at the national level, for example, as incompatible national rules would be trumped by treaty freedoms. Also, this approach relies less on political decision making and more on an increased role of the ECJ. Positive integration through harmonization initiatives, on the other hand, always requires sufficient political support, whereas the effects of such harmonization initiative can vary depending on the policies pursued at the supranational level[83].

Market integration in the EU has over the past decade been largely based on negative integration reflected in the string of landmark cases by the ECJ. Also, the principles of subsidiarity and proportionality included in the Treaty on European Union[84] point towards a preference of negative integration by requiring that any centralized measures must be appropriately justified. The principle of proportionality, moreover, requires EU initiatives not to "exceed what is necessary to achieve the objectives of the Treaties"[85]. It has also been argued that the policies underlying EU level regulation have reflected a neo-liberal political agenda and a "marketization" of corporate control[86]. The more recent initiatives to introduce EU level corporate governance regulation may thus have reflected a clear diversion from previous policies resulting in strong reactions from affected constituencies.

Another political factor that affects the development of corporate governance regulation is the political salience of corporate governance. Corporate governance regulation does not generally draw considerable public attention. The matters at hand are not of immediate interest to the public and in many respects are in the focus of specialized interest groups only[87]. The main constituencies traditionally identified in the corporate governance context include different groups of shareholders, management and employees. Creditors are another external constituency, along with employees, that also has significant interests in corporate governance that can be pursued through policy and regulation.

As long as corporate governance regulation remains a "low salience"[88] matter the political dynamic, and the related "market for regulation", is mainly dominated by the traditional interest groups, i.e. investors, management and employee groups. However, to the extent that corporate governance related issues do become matters of "high salience" that dynamic can

---

[82] Johnston (2009), *supra* note 26, at 115-116.
[83] *Id.*
[84] Consolidated version of the Treaty on European Union, Oct. 26, 2012, OJ C 326, *available at* http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A12012M%2FTXT [hereinafter TEU].
[85] *Id.,* Art 5. *See also* Consolidated Version of the Treaty on the Functioning of the European Union, *Oct. 26, 2012, OJ C 326, available at* http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:12012E/TXT&from=EN [hereinafter the TFEU].
[86] *See* Bastiaan van Apeldoorn & Laura Horn, *The Transformation of Corporate Governance Regulation in the European Union: From Harmonization to Marketization, in* THE TRANSNATIONAL POLITICS OF CORPORATE GOVERNANCE REGULATION 77 (Henk Overbeek, Bastiaan van Apeldoorn & Andreas Nölke, eds., 2007).
[87] *See* PEPPER D. CULPEPPER, QUIET POLITICS AND BUSINESS POWER (2011).
[88] *Id. at 54-55.*

change significantly. Significant reforms of securities and corporate law are often launched in the aftermath of market crisis[89] and such initiatives may be affected by the sense of urgency and public outcry related to the crisis[90].

In connection with the financial crisis matters related to corporate governance have been the focus of public interest. Corporate governance arrangements have been recognized to include elements related to corporate legitimacy and possible externalities caused by corporations on society. The concerns in this regard can be that inadequate management accountability would lead to excessive risk taking which, if those risks realized, would fall upon society at large to cover. However, as the salience of corporate governance regulation increases, it can be used as an avenue to pursue politically topical issues in order to demonstrate the responsiveness of the political system to public concerns. The matters that do become "high salience" issues are likely to be matters that capture the public interest. The traditional dynamic related to corporate governance regulation no longer applies to these issues, and it is possible that corporate constituencies and their lobby representatives are not able to resist regulatory action in these areas. Politicians now respond to completely different interest groups and must be seen to be active in the face of a public outcry.

The problem with high salience matters is that regulation might be introduced that is costly and ill-advised and has a negative effect on the competitiveness of the regulated businesses. The regulated activities may be targeted for political reasons rather than based on sound regulatory policies. With respect to recent corporate governance initiatives, listed companies have already been subject to a regulatory framework at the EU level as several directives apply specifically to the governance of listed companies. As these companies are already captive to regulation, the threshold is lower to specifically target listed companies with new regulatory initiatives.

The Centralization of the Sources of Regulation

There has been much political focus on corporate governance in the years following the financial crisis. The EU Commission, for example, has voiced its concern that inadequate corporate governance arrangements may have contributed to the financial crisis. The EU Commission is not alone in these concerns as OECD reports on corporate governance and the financial crisis have also found that "weaknesses in remuneration, risk management, board practices and the exercise of shareholder rights had played an important role in the development of the financial crisis"[91]. Interestingly, the EU is addressing these very same concerns in the Company Law Action Plan. The G-20 group of countries has also published statements on the need to develop financial regulation and the corporate governance of financial institutions.

The examples described above suggest that regulatory initiatives can move to international forums outside of traditional political frameworks. The work at the OECD level and at the G-

[89] See Klaus J. Hopt, *Comparative Corporate Governance: The State of the Art and International Regulation* 16-17 (ECGI Working Paper No. 170, 2011), *available at* http://ssrn.com/abstract_id=1713750, John Armour & Wolf-Georg Ringe, *European Company Law 1999 - 2010: Renaissance and Crisis* 6 (ECGI Working Paper No 175, 2011), *available at* http://ssrn.com/abstract=1691688, AFTER ENRON: IMPROVING CORPORATE LAW AND MODERNIZING SECURITIES MARKETS (John Armour and JA McCahery, eds. 2006).
[90] Hopt (2011), *supra* note 89, at 17.
[91] OECD, CORPORATE GOVERNANCE AND THE FINANCIAL CRISIS: KEY FINDINGS AND MAIN MESSAGES, 2009, *available at* http://www.oecd.org/corporate/ca/corporategovernanceprinciples/43056196.pdf [hereinafter OECD Corporate Governance Report].

20 summits has considerable political effect on how regulation is adopted. Countries participating in the relevant international summits have undertaken to cause regulation to be adopted along the lines agreed in common statements of purpose. Consequently, the basis for regulatory intervention has, to some extent, been formulated and agreed in connection with international summits rather than through the political frameworks at the national or even regional levels, such as the EU. For the EU this development represents a challenge to its regulatory independence, but it also provides an opportunity for the EU Commission to establish itself as a participant in international regulatory work. It seems, however, that the national level political framework within the EU is becoming less significant in this process. This trend emphasizes the importance of EU level regulation. Moreover, it is this development that may form the basis for the federalization of EU corporate and corporate governance regulation. I.e. the political prerequisites for maintaining the national level as a source of regulation may be diminishing in an increasingly globalized world, where perceived market failures will be addressed by global forums.

Finally, the public choice literature identifies the regulators as one of the key actors in the market for regulation – such as the EU institutions. The EU Commission and the EU agencies have independent agendas for expanding their own authority and influence at the cost of national authorities. Current political trends support these efforts, as has been discussed above.

D. Regulatory Implications

This study is concerned with the development of corporate governance regulation in the EU in light of recent EU initiatives in the field. The study adopts a political approach to corporate governance and, first, recognizes that the impact of EU level corporate governance regulation is likely to remain significant. The political dynamics of regulatory development seems to suggest that regulatory initiatives are likely to be centralized to more international forums, and that the role of the EU will increase in importance at the cost of national regulation. Moreover, institutional complementarities and national lock-ins remain strong enough so regulatory competition may not provide solutions sufficiently quickly, and that there will therefore be pressure to introduce further EU level initiatives.

It is clear that the institutional environment varies significantly within the EU, and that developing uniform regulation to be applied through the EU will continue to pose significant challenges. However, this does not imply that national level regulation and regulatory competition are necessarily the superior alternative. Instead, these factors must be better taken into account in the legal strategies adopted at the EU level.

When preparing regulatory initiatives it is also important to recognize and identify the political aspects of corporate governance regulation. The feasibility of introducing specific regulatory mechanisms must also be considered in light of the political dynamic. The political economy sets out the framework for feasible regulation, and changes in political influence affect regulatory preferences. This means that regulators should consider alternative regulatory mechanisms to address regulatory concerns and choose mechanisms and regulatory designs that are politically feasible.

This study will consider these aspects with respect to the Company Law Action Plan of 2012, and the key regulatory proposals thereunder. The study will consider whether the action plan reflects a shift in the relative bargaining power among key corporate constituencies in the EU.

The study also considers how the Company Law Action Plan is adapted to different corporate governance systems – with a focus on concentrated ownership, which remains a prevalent feature in the European corporate environment.

III. THE EU COMPANY LAW ACTION PLAN

EU regulation of company law has evolved significantly over the past decade. After the failure of comprehensive initiatives, such as the Fifth Company law Directive Proposal[92], the EU Commission in 2003 issued a communication with the aim of modernizing company law[93]. In this action plan, the Commission adopted a more instrumental view on harmonization[94]. The introduction of EU level regulation would be based on an impact assessment and an analysis of the needs of businesses[95]. Harmonization efforts would not be introduced for the purposes of creating a level playing field alone. Regulatory intervention was also to be focused primarily on cross-border aspects of business where EU regulatory intervention could be better justified. Also, the regulatory mechanisms that would be used at the EU level should be "flexible in application, but firm in the principles"[96]. At the same time the EU also pursued a policy of simplifying the business environment for companies envisaging the development of a principles-based regulatory model corporate law in the EU[97].

Following the financial crisis, the Commission has pursued a more interventionist agenda with respect to corporate governance. The EU Commission first targeted financial institutions and introduced, among other, requirements on board structures in financial institutions[98]. The Commission then published a green paper on developing the EU corporate governance framework for listed companies in general[99] (the "Corporate Governance Green Paper"). Based on the feedback received on the Corporate Governance Green Paper the Company Law Action Plan was published in late 2012. Many of the more controversial initiatives in the green paper had been deleted from the action plan. However, there has still been strong opposition to many of the proposals in the plan[100].

---

[92] *Supra* note 16.

[93] *Communication from the Commission to the Council and the European Parliament - Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward,* COM2003(284) (May 21, 2003) [hereinafter the "Company Law Action Plan 2003].

[94] *See* John Armour and Wolf-Georg Ringe, *European Company Law 1999 - 2010: Renaissance and Crisis* (ECGI Working Paper No 175, 2011), *available at* http://ssrn.com/abstract=1691688

[95] *Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe,* at 4 and 29-31, Nov. 4, 2002*, available at* http://www.ecgi.org/publications/documents/report_en.pdf.

[96] Company Law Action Plan 2003, *supra* note 93, at 4.

[97] Resolution of 21 May 2008 on a Simplified Business Environment for Companies in the Area of Company Law, Accounting and Auditing, EUR. PARL. DOC. (2007/2254(INI)), [2009] OJ C279E/36.

[98] *See* http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm, *and* Regulation 575/2013 of the European Parliament and of the Council of 26 June 2013 on Prudential Requirements for Credit Institutions and Investment Firms and Amending Regulation (EU) No 648/2012 (1); *see also* Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms, Amending Directive 2002/87/EC and Repealing Directives 2006/48/EC and 2006/49/EC (1).

[99] *See European Commission Green Paper, The EU Corporate Governance Framework*, COM(2011) 164 final (Apr. 5, 2011) [hereinafter the "Corporate Governance Green Paper"].

[100] *See* Swedish Corporate Governance Board, *Views on the EU Green Paper on the Corporate Governance Framework*, 19.7.2011, *available at* http://www.bolagsstyrning.se/media/53853/views%20on%20eu%20cg%20framework%20from%20the%20swedish%20cg%20board%202011-07-19.pdf.

Pursuant to the Company Law Action Plan the Commission has launched, and intends to launch, a number of specific regulatory initiatives[101]. One of the more important initiatives is the proposed amendment of the Shareholder Rights Directive[102]. The directive was intended to facilitate the use of shareholder rights throughout the EU setting minimum standards on access to information prior to general meetings, provisions on proxy voting and voting without physical participation. The directive also prohibited requirements for share blocking whereby a shareholder would not be able to trade shares during a period of time before the shareholders' meeting in order to use voting rights. Other initiatives taken so far include amendments to the Accounting Directives[103] and a Recommendation on corporate governance disclosures[104].

A. REGULATORY POLICIES OF THE COMPANY LAW ACTION PLAN

The stated starting point of the Company Law Action Plan has been to address shortcomings in corporate governance that, in the view of the Commission, have contributed to the lack of accountability in the management of corporations. The Commission points out that in the prevalent systems of corporate governance "[s]hareholders have a crucial role to play in promoting better governance of companies"[105] and finds shortcomings in this regard. The Commission argues that there has been a "lack of shareholder interest in holding management accountable for their decisions and actions, compounded by the fact that many shareholders appear to hold their shares for only a short period of time" and also finds shortcomings in the effectiveness of corporate governance rules based on the "comply-or-explain" principle[106].

Regulatory Policies

In the Company Law Action Plan, the EU Commission identified three different areas for further regulatory initiatives. With the aim of modernizing company law and the corporate governance framework the Commission looks to ways of (i) enhancing transparency, (ii) engaging shareholders and (iii) supporting companies' growth and competitiveness especially with regard to enhancing cross-border business. The Commission identifies several measures to be taken pursuant to these principles, some of which will be briefly referred to here. First, to increase transparency, the Commission states it will, among other, strengthen disclosure requirements with regard to risk management and board diversity policies, as well as corporate governance reports. Institutional investors and asset managers will be required to disclose voting and engagement policies and their voting records. Second, shareholder engagement would be facilitated by introducing regulation on say-on-pay and related party transactions. The Commission has also sought to promote shareholder engagement by clarifying the relationship between investor cooperation on corporate governance and "acting in concert". Importantly, the Commission also looks to facilitate the use of shareholder rights – noting that a significant portion of shareholdings in the EU are held cross-border and that

---

[101] *See* the Company Law Action Plan, *supra* note 1, at 17-18.
[102] *Supra* note 3.
[103] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the Annual Financial Statements, Consolidated Financial Statements and Related Reports of Certain Types of Undertakings, Amending Directive 2006/43/EC of the European Parliament and of the Council and Repealing Council Directives 78/660/EEC and 83/349/EEC, OJ 29.6.2013, L182/19.
[104] Commission Recommendation of 9 April 2014 on the Quality of Corporate Governance Reporting ('Comply or Explain'), (2014/208/EU).
[105] Company Law Action Plan, *supra* note 1, at 3.
[106] *Id.*

costs related to using shareholder rights may hinder shareholder oversight in these situations[107].

"Short-termism"

An important element underlying the Company Law Action Plan, as well as the proposed amendments to the Shareholder Rights Directive, is the perceived need to engage shareholders to avoid "short-termism" in the markets. There has been an emerging perception that short-term performance of companies has been overly emphasized by investors and managers alike, and that this could pose significant problems[108]. Short-termism has been defined as "the excessive focus of corporate managers, asset managers, investors and analysts on short-term results, whether quarterly earnings or short-term portfolio returns, and a repudiation of concern for long-term value creation and the fundamental value of firms"[109]. For companies this could entail seeking to increase stock prices or profits by "inflating current earnings at the expense of the long-term health of the firm by, for example, decreasing discretionary expenses, under-investing in long-term assets, or taking on excessive risk to maximize short-term earnings"[110].

A basic problem has been that management has been rewarded based on short-term performance and has not been incentivized to pursue long-term interests. The development of short-term trading strategies has supported this trend. This behavior becomes a problem if markets fail to price such corporate action appropriately. There has been some concern that companies provide information that signals superior short-term performance at the cost of long-term health of the corporation. Findings in the area of behavioral economics have also been referred to with regard to incorrect pricing of company stock. These include hyperbolic discounting, i.e. the behavioral tendency to heavily discount long-term income. In other words, pricing is too heavily based on short term performance[111]. Herding has also been identified as a problem exasperating this tendency – i.e. the pattern of investors following "the market" without independent analysis of the underlying values. It has also been argued that low-frequency events or risks, such as the financial crisis, are also not properly taken into account in market based pricing.

Based on these assumptions, the Commission emphasizes the need for involving long-term investors in corporate decision making. The Commission believes that shareholder engagement is primarily suited to improve long-term returns to shareholders and that therefore investors with a long-term view have an interest in engagement. The proposals for addressing these concerns include facilitating the participation of these shareholders in corporate decision making. The Commission believes that the passiveness of these shareholders is due, in part, to the costs and uncertain returns of participating in corporate decision making. Individual shareholders incur costs for their participation which are not in appropriate relation to their interests (free-rider problem). If shareholder participation is facilitated, there will be more direct shareholder engagement in corporate decision making

---

107 *Supra* note 3, at 5.
108 *See* CFA CENTER FOR FINANCIAL INTEGRITY & BUSINESS ROUNDTABLE INSTITUTION FOR CORPORATE ETHICS, BREAKING THE SHORT-TERM CYCLE, 2006, *available at* http://www.corporate-ethics.org/pdf/Short-termism_Report.pdf.
109 Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance*, 37 J. OF CORP. L. 264, 267 (2011).
110 *Id.*
111 *Id.* at 269.

which would also allow long-term views to be appropriately reflected in corporate decision making.

However, there is some doubt as to the extent of "short-termism" in the markets and even, in fact, to whether this is a real and significant problem at all.[112] It has been argued that there is no clear evidence that these developments pose a structural problem. It can also be questioned whether discouraging short-termism and favoring long-term investments might also have negative consequences. There might be more tolerance of ineffective management and sub-par performance, for example. Overall, there may be inadequate evidence of the effects of this perceived phenomenon to form a solid basis for significant policy choices[113]. It is also important to recognize that concerns regarding "short-termism" can be used as a pretext to promote unrelated regulatory policies or the interests of corporate or political constituencies. In any case, to understand the true dynamics of the Company Law Action Plan, it is justified to assess how the initiatives introduced pursuant to the plan affect interests of relevant constituencies.

B. INCREASING TRANSPARENCY IN CORPORATE GOVERNANCE

The Company Law Action Plan includes several steps to increase transparency with the stated aim of having better informed shareholders, and allow better interaction in matters pertaining to corporate governance. The steps identified in the Company Law Action Plan include disclosure of board diversity and management of non-financial risk, as well as measures to allow companies to better identify their shareholders.

Diversity Reports

The EU Commission has been concerned with the diversity issues in respect of board structure. Gender equality in employment relationships and gender balance in the business environment in general have been topical issues for some time. Gender balance on boards of directors, in particular, has been an important political issue in a number of EU member states as well. Some EU (or EEA) member states, including France, Germany, Italy and Norway, have already introduced gender quotas for listed companies. Other countries have addressed the matter through corporate governance codes and other non-binding programs. Political pressure has been increasing to introduce mandatory quotas on a broader basis. However, it could be argued that such requirements would limit shareholders' control rights and introduce unwarranted external requirements on corporate governance.

The Corporate Governance Green Paper inquired whether listed companies should ensure a better gender balance on boards[114]. The paper also noted the lack of international diversity on boards of directors stating that one in four large listed companies in the EU has no foreign board members[115]. Proposals regarding gender or other quotas on boards were strongly

---

[112] *See* European Company Law Experts, *Response to the European Commission's Green Paper "The EU Corporate Governance Framework"*, 2011, *available at* http://ssrn.com/abstract=1912548 [hereinafter Expert Report 2011].

[113] *Id.* at 14; see also Ronald Gilson & Jeffrey Gordon, *The Agency Costs of Agency Capitalism: Acitivist Investors and Revaluation of Governance Rights*, 113 COLUMBIA L.R. 863 (2013), introducing activist investors as a mechanism for addressing governance challenges.

[114] Corporate Governance Green Paper, *supra* note 99, at 6-7; *see also Proposal for a Directive of the European Parliament and of the Council on Improving the Gender Balance Among Non-executive Directors of Companies Listed on Stock Exchanges and Related Measures*, November 14, 2012, COM(2012) 614 final.

[115] Corporate Governance Green Paper, *supra* note 99, at 6.

opposed in the feedback to the Corporate Governance Green Paper and the Commission has opted to pursue increased transparency regarding diversity issues. In the Company Law Action Plan the Commission argues that diversity of views among board members enables the board to effectively engage and challenge management, where as insufficient diversity could lead to "group-think" and less effective oversight[116]. The Commission takes the view that increased transparency regarding board diversity could make companies reflect on the benefits of diversity. Subsequent to the Company Law Action Plan, amendments have been introduced to the Accounting Directives obligating larger companies to disclose their diversity policies with regard to the board and management and how these have been implemented[117].

Diversity and gender equality are important matters in society at large - no less so in the business and corporate communities. It is interesting, however, that these policies are being pursued specifically through regulation targeting the boards of publicly listed companies. The Commission fails to explain why it prioritizes the corporate governance of listed companies, in particular, as a forum for focusing on gender equality[118].

Improving Corporate Governance Reporting

The Commission also looks to improve corporate governance reporting. In the Company Law Action Plan, the Commission has identified shortcomings in the quality of explanations of companies opting out from corporate governance regulation which is applied on a "comply-or-explain" basis, which was adopted as a feature of softer enforcement of corporate governance codes in EU accounting regulation[119]. In spring 2014 the Commission issued a recommendation on improved corporate governance reporting in this regard[120]. In the recommendation the Commission notes that member states have taken some steps to improve the quality of explanations and that there has been gradual improvement. Nevertheless, the Commission emphasizes the need for clearer and better explanations, and issues guidelines to be noted by member states and bodies responsible for national corporate governance codes.

The Company Law Action Plan also looks to facilitate the ability of companies to identify their shareholders. If companies do not know who their shareholders are they may not be able to understand shareholder preferences and concerns and cannot engage in dialogue in matters pertaining to corporate governance. A degree of transparency is already provided by the notification requirements in the Transparency Directive[121] related to shareholdings over certain thresholds. However, there has been an interest among corporations and other market

[116] Company Law Action Plan, *supra* note 1, at 6.
[117] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the Annual Financial Statements, Consolidated Financial Statements and Related Reports of Certain Types of Undertakings, Amending Directive 2006/43/EC of the European Parliament and of the Council and Repealing Council Directives 78/660/EEC and 83/349/EEC *and* Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 Amending Directive 2013/34/EU as Regards Disclosure of Non-financial and Diversity Information by Certain Large Undertakings and Groups.
[118] Belcredi & Ferrarini (2013), *supra* note 7, at 29.
[119] Directive 2013/34/EU, *supra* note 103, Article 20.
[120] *See* Commission Recommendation 2014/208, *supra* note 104.
[121] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the Harmonisation of Transparency Requirements in Relation to Information about Issuers Whose Securities Are Admitted to Trading on a Regulated Market and Amending Directive 2001/34/EC [herein the Transparency Directive"].

participants for at least the issuers to have better insight into the identity of their shareholders. In the Company Law Action Plan the Commission confirms its aim to facilitate this[122].

C. ENGAGING SHAREHOLDERS

An important aspect of the Company Law Action Plan is the effort to facilitate shareholder engagement. The Commission sees that "(e)ffective, sustainable shareholder engagement is one of the cornerstones of listed companies' corporate governance model"[123]. The Commission argues that shareholders should have better oversight and control over certain corporate affairs, such as management remuneration and related party transactions, for example.

The key policies pursued in this regard were included in the Commission proposal to amend the Shareholders Rights Directive. The proposed changes to the directive look to further facilitate shareholder engagement and include provisions on say-on-pay and shareholder approval of related party transactions. The proposed amendments also include enhanced transparency requirements for institutional investors, asset managers and proxy advisers.

Say-on-Pay

According to the proposal the general meeting of shareholders will have increased oversight and control over management remuneration. A general meeting must approve the remuneration policy of a listed company every three years and can also vote annually on the company's reported remunerations. The directive does not regulate the level or form of remuneration as such.

The proposals on say-on-pay have been subject to further revision in the legislative process involving the Council and the EU Parliament[124]. The revisions have mainly focused on further strengthening disclosure requirements and the transparency of management remuneration.

Related Party Transactions

The Commission proposal also included new regulation on related party transactions. According to the initial proposal of the Commission, related party transactions representing more than five percent of the company's assets or transactions with a significant impact on profits or turnover must be approved by shareholders, and a shareholder involved in the transaction would be excluded from the vote. Enhanced disclosure obligations would apply to smaller related party transactions. Also, a report assessing whether the transaction is on market terms would need to be obtained from an independent third party.

The Commission has expressed concern that regulation regarding related party transactions has been unsatisfactory. At the EU level, only disclosure has been required with respect to

---

[122] Company Law Action Plan, *supra* note 1, at 7.
[123] *Id.* at 8.
[124] *See Council of the European Union, Interinstitutional File 2014/0121(COD)*, 20 March 2015, 7315/15, Art 9b, at 42-42, *and European Parliament, Report on the Proposal for a Directive of the European Parliament and of the Council Amending Directive 2007/36/EC as regards the Encouragement of Long-term Shareholder Engagement and Directive 2013/34/EU as regards Certain Elements of the Corporate Governance Statement,* May 12, 2015, A-8-0158/2015, *and European Parliament, Long-term Shareholder Engagement and Corporate Governance Statement,* July 8, 2015, P8_TA-PROV(2015)0257 [hereinafter Parliament Amendments].

related party transactions. In the context of concentrated ownership, in particular, disclosure has been seen as an inadequate means to effectively prevent the potential for abuse[125].

The Commission proposal has been controversial in this regard, and subject to intense debate[126]. The Council and the EU Parliament have proposed amendments to the proposal that would allow member states to provide for alternative measures to regulate related party transactions, including approval by administrative bodies (instead of the general meeting of shareholders only) and allow related party shareholders to participate in voting on the transactions provided measures are available that protect the minority shareholders in these situations[127].

Institutional Investors and Intermediaries

New requirements are also placed on institutional investors. The Commission proposes to require institutional investors and asset managers to develop a policy on shareholder engagement, including guidelines on the monitoring and engaging in dialogue with individual companies and on the exercise of voting rights. Institutional investors and asset managers are also required to disclose "how their equity investment strategy … is aligned with the profile and duration of their liabilities and how it contributes to the medium to long-term performance of their assets"[128]. The proposal further explicitly requires asset managers to disclose whether they are incentivized to make investment decisions based on medium to long-term company performance, including non-financial performance.

The Commission's initiative follows the introduction of the shareholder stewardship code for institutional investors in the United Kingdom in 2010[129]. The UK Stewardship Code sets out standards for how institutional investors should engage with the investee companies and requires disclosure of the investors' policies in this regard. The code is addressed to asset managers who manage funds on behalf of institutional shareholders, including pension funds, insurance companies, and investment trusts. The code is issued by the UK Financial Reporting Council, a self-regulatory organization promoting corporate governance. The introduction of the code was also based on the understanding that the effectiveness of prevailing corporate governance models assumes that shareholders actively engage with and monitor corporate decision making. There was concern that shareholders were not sufficiently taking on these duties.

Acting in concert

In line with the goal of facilitating shareholder engagement the Commission has looked to clarify regulation regarding the ability of shareholders to cooperate in matters pertaining to corporate governance. It has been unclear to what extent provisions regarding "acting in concert" in the Takeover Directive for the purposes of triggering the requirement to make a mandatory public tender offer might limit the ability of shareholders to exchange information

[125] Corporate Governance Green Paper, *supra* note 1, at 17.
[126] *See* Klaus Hopt, *Corporate Governance in Europe – A Critical Review of the European Commission's Initiatives on Corporate Law and Corporate Governance*, 12 N.Y.U. J.L. & BUS. 139, 155-158 (2015).
[127] *Supra* note 124.
[128] *Supra* note 3, Article 3f.
[129] FINANCIAL REPORTING COUNCIL, THE UK STEWARDSHIP CODE 2012*, available at* https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Stewardship-Code-September-2012.pdf.

and to cooperate[130]. In 2013 the European Securities and Markets Authority issued a white list outlining means of cooperation that would not trigger acting in concert issues under the Takeover Directive[131]. However, the white list is very limited in scope reflecting current practices in member states and does not provide much added comfort to shareholders beyond the language of the directive. The Commission also decided not to open the Takeover Directive for amendments – possibly due to the risk of increased protectionist tendencies in many EU member states[132].

Employee share ownership

In the Company Law Action Plan the EU Commission investigates the possibility to promote employee shareholdings in listed companies. The Commission believes that shareholdings by employees could increase "the proportion of long-term-oriented shareholders"[133]. The EU Commission recognizes that employees are less diversified than other shareholders, as they rely on income from the company as both employees and shareholders and would therefore be interested in the long-term sustainability of the company. The Commission sets out to identify obstacles to trans-national employee share ownership-schemes and will then look to "encourage employee share ownership throughout Europe"[134].

D. FACILITATING CROSS-BORDER OPERATIONS OF EU COMPANIES

The EU Commission has also stated it wishes to facilitate freedom of establishment of companies and enhance legal certainty through the development of EU company law. In the Company Law Action Plan, the Commission publishes its intention to investigate cross-border transfers of registered offices of companies in the EU in light of the *Vale*-ruling[135]. The Commission is also looking to consider further facilitating cross-border mergers and demergers. The directive on cross-border mergers[136] already allows for companies to merge with others across the EU member states, but uncertainties are said to remain with regard to differing procedural and substantive rules related to mergers, such as creditor's rights or methods for the valuation of assets, for example[137]. The Company Law Action Plan also explicitly makes reference to allow for cross-border demergers as well, which have not been universally recognized in the EU. The action plan also refers to developing EU level legal forms for companies, including corporate forms better adapted to smaller corporations, and developing the SE form. These initiatives could form the basis for more regulatory competition among the EU member states. The first steps in this regard have already been witnessed with a trend of German companies opting to re-establish in the UK through the SE structure. There has also been a notable increase in the number of cross-border mergers in the EU[138].

---

130 Company Law Action Plan, *supra* note 1, at 11.
131 The European Securities and Markets Authority, Information on shareholder cooperation and acting in concert under the Takeover Bids Directive, ESMA/2013/1642 Public Statement.
132 Hopt (2015), *supra* note 126, at 197-198.
133 Company Law Action Plan, *supra* note 1, at 11.
134 *Id.*
135 Case C-378/10 VALE Építési kft. [2012] ECR 00000.
136 Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on Cross-border Mergers of Limited Liability Companies, (OJ L 310, 25.11.2005).
137 Company Law Action Plan, *supra* note 1, at 12.
138 Bech-Bruun & Laxidale, Study on the Application of the Cross-Border Mergers Directive, Markt/2012/031/F, *available at* http://ec.europa.eu/internal_market/company/mergers/index_en.htm.

IV. AN ASSESSMENT OF THE POLITICAL ASPECTS OF THE COMPANY LAW ACTION PLAN

In relation to the debate on corporate governance in the EU there has been concern on how EU level corporate governance regulation reflects the political evolution of the EU. There has been much research about the liberalization and marketization[139] of corporate law in the EU on terms, some argue, that do not take into account the differences in economic structures among EU member states and that subsequently can have negative effects on economic and social development. The failures in introducing more comprehensive corporate governance initiatives at the EU level have been explained with reference to the differences in the economic systems. Political resistance has been explained with references to the position of labour in corporate governance, among other. As discussed, the Fifth Company Law Directive Proposal was one of the more controversial initiatives in this regard. It reflected a model with significant labour participation in governance, but met heavy resistance within the EU. The proposal was ultimately not adopted, and some years later a company law action plan was introduced that represented a less intrusive regulatory approach and reflected increasingly pro-business policies[140]. The Takeover Directive has been seen as another milestone with one of the failed versions argued to "constitute the high water mark of an attempt to import neo-liberal governance structures into Continental Europe"[141]. It has been argued that the development of EU level corporate governance regulation since the introduction of the Company Law Action Plan 2003 has represented a shift towards Anglo-Saxon governance and a marketization of corporate control linked with an overall political shift towards market liberalism at the EU level[142].

In light of the developments referred to above it is interesting to assess the political aspects of the 2012 Company Law Action Plan. The controversy surrounding these initiatives suggests that they may reflect a change in the overall policies of EU corporate governance. The political economy implications of the Company Law Action Plan will be considered in more detail below.

A. THE COMPANY LAW ACTION PLAN AND CORPORATE CONSTITUENCIES

Shareholders, Management, Employees

The amendment of corporate governance regulation can be seen, to an extent, to reflect changes in the relative political bargaining power of affected constituencies. In analyzing the Company Law Action Plan it can be helpful to consider which corporate constituencies would be best served by the Commission initiatives – and which would not be.

The relative bargaining power of the key corporate constituencies, i.e. shareholders, management and employees, in a particular institutional environment, is reflected in how corporate governance regulation allocates cash flow and control rights among these constituencies. Differences in how corporations are controlled are reflected in the legal

---

[139] *See* van Apeldoorn & Horn (2007), *supra* note 86; *and* LAURA HORN, REGULATING CORPORATE GOVERNANCE IN THE EU: TOWARDS A MARKETIZATION OF CORPORATE CONTROL (2011).
[140] *See* Company Law Action Plan 2003, *supra* note 93.
[141] John W. Cioffi, *The Collapse of the European Union Directive on Corporate Takeovers: The EU, National Politics, and the Limits of Integration* (Berkeley Roundtable on the International Economy, Discussion Paper September 28, 2001) *available at* http://www.brie.berkeley.edu/publications/John%20Cioffi's%20paper.pdf.
[142] Horn (2011), *supra* note 139.

powers of different corporate constituencies[143]. Corporate constituencies can use the political system to renegotiate these legal powers – or the terms of their relationships with each other. Financial crisis or the evolution of new regulatory systems, such as an increase of the relative influence of EU level regulation, can be factors that allow politically dominant constituencies to change the terms of the bargain. In this regard, it can be noted that the Company Law Action Plan highlights excessive risk-taking by corporations, and emphasizes the role of long-term investors and the stability of corporations. The promotion of low-risk policies could generally be argued to benefit employees and creditors at the cost of dispersed shareholders[144]. Encouraging employee ownership may also be interpreted in this light. As a shareholder block employees may favor policies that support increased employment levels rather than value maximization or the competitiveness of the corporation. Employees may not be concerned with the value of the share as such, as long as the company's business remains on a satisfactory level to guarantee continued employment.

As such, it would not be unexpected that regulation would favor creditor and labor-oriented interests in the political environment following the financial crisis. In fact, in connection with the Commission initiated corporate governance reform there have been proposals that could have resulted in increased influence of management and employees and in the entrenchment of corporate control. For example, the Reflection Group Report[145], to address "short-termism", proposed allowing companies to amend their articles "to make it easier for longer term objectives to prevail over short-term oriented pressure of certain shareholders"[146]. Company articles could provide explicitly, for example, that "the board and the management of the company have to run it primarily in the interests of the company…which may have a priority over the interests of individual shareholders if these two are in conflict and if serving the short term interest of shareholders would have a direct impact on the long-term viability of the company"[147]. The introduction of regulation in this respect could well have had a significant effect on the relative power of the board and management vs. that of shareholders. The initiative would have been a step towards "director primacy" giving the board the central position in corporate hierarchy. Also, the Corporate Governance Green Paper suggested that steps might be taken to encourage employee shareholdings in order to obtain shareholder blocks with, possibly, more long-term oriented goals. These proposals were not adopted in the Company Law Action Plan, however. In fact, on the whole the action plan does not significantly alter the balance of control rights towards increased control by management and employees.

The stated goal of the Company Law Action Plan is to facilitate shareholder engagement which would be in line with shareholder-oriented corporate governance policies. The say-on-pay provisions empower shareholders, and mechanisms for monitoring related party transactions increase investor protection. The Company Law Action Plan also seeks to facilitate cross-border establishment and to limit national restrictions in this regard. These policies favor a shareholder-oriented model of corporate governance as well. At the same

143 *See* Sofie Cools, *The Real Difference in Corporate Law between the United States and Continental Europe: Distribution of Powers* (Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series, Paper 490, 2004) *available at* http://lsr.nellco.org/harvard_olin/490.
144 *See* Gourevitch & Shinn (2005), *supra* note 64.
145 *See* Reflection Group Report, *supra* note 5.
146 *Id.* at 37.
147 *Id.* at 37-38.

time, however, new disclosure obligations on intermediaries slightly increase the costs of shareholder engagement.

As discussed above, there is a perceived conflict between the interests of beneficial shareholders and those of intermediaries, including asset managers and other parties who hold shares on behalf of the ultimate investors. The Company Law Action Plan seems to recognize this conflict and seeks to address the perceived regulatory concerns regarding the incentives of the intermediaries through increased transparency requirements. While the proposals would not result in significant changes in the relative control rights and interests among corporate constituencies, intermediaries would end up with increased costs for holding shares on behalf of diversified shareholders.

Corporate Governance and Concentrated Ownership

It is interesting to observe how the proposals are adapted to different structures of corporate ownership. Concentrated ownership remains predominant in many EU jurisdictions, and controlling shareholders maintain strong control rights overall. At the same time the evolution of institutional shareholding has resulted in more transparency in corporate governance systems. How do the Company Law Action Plan initiatives affect the relative rights of controlling shareholders?

In an environment of concentrated ownership the new say-on-pay rules are likely to have less of an impact, as controlling shareholder are already able to directly impact the principles of management remuneration[148]. However, the proposals on related party transactions directly affect the ability of large shareholders to transact with a listed corporation. According to the initial Commission proposal transactions between the company and a major shareholder would need to be approved by the general meeting of shareholders if the value of the transactions was more than five per cent of the company's assets. The shareholder transacting with the company would not be allowed to vote in such matters. In the context of concentrated ownership this could invite opportunistic behavior from minority shareholders with relatively smaller interests involved. In the context of a concentrated ownership system, minority shareholders could even look to extract benefits from approving such transactions. However, transactions between the company and the main shareholder may be an important element of the relationship and a key to the success of the corporate enterprise. Alternative control mechanisms that would be less problematic in this context might include setting standards for related party transactions, and requiring approval by independent board members or review by third party independent experts.

As discussed, the Commission proposal has raised much controversy and amendments have been introduced during the legislative process. To some extent the changes would address the concerns identified above. The amended proposals provide that related party transactions can also be approved by administrative bodies instead of the general meeting of shareholders. They would also allow a related party shareholder to participate in voting for approving the transactions, provided minority protection mechanisms are applied that address the potential for abuse. However, the proposals do not address the nature of such mechanisms nor do they analyze what type of mechanisms wouold be appropriate and effective in the context of concentrated ownership. It will be interesting to observe how these concerns affect the final regulatory instruments introduced at the EU level.

---

148 Belcredi & Ferrarini (2013), *supra* note 7, at 31-32.

It is also unclear whether the reporting requirements for institutional investors will have the expected effects in companies with concentrated ownership. First, it is not clear that the requirements regarding increased monitoring are cost-effective in the first place, as institutional investors will be carrying the burden of monitoring. However, in connection with concentrated ownership these requirements seem superfluous. A considerable portion of listed companies in the EU will have controlling shareholders, such as families, foundations and institutions, with large block-holding positions. These types of shareholders are likely to already be engaged in active monitoring of management. Increasing the administrative burden of institutional investors in this type of environment will not increase the ability of institutions to affect the matters of the corporation, and may not be as relevant.

These observations are relevant in highlighting the differences in regulatory concerns in different types of corporate environments that are prevalent in the EU, and the challenges related to introducing EU level instruments that are applied throughout the EU area.

B. Political Salience and External Corporate Governance Considerations

In the context of the financial crisis it is to be expected that the political salience of corporate governance has increased and that legislators must cater to the desires of voters with an increased focus on the corporate environment. Listed companies are subject to a regulatory framework at the EU level and several directives apply specifically to the governance of listed companies. As these companies are already captive to such regulation, the threshold is lower to introduce new regulation in this field.

The Company Law Action Plan can be seen as a representative case of crisis-based regulatory initiatives. The financial crisis also triggered a crisis in corporate governance regulation[149]. Studies issued in the aftermath of the crisis seeking to understand its reasons identified, among other, insufficient monitoring of risk taking in financial institutions in particular, but in corporations more generally as well[150]. There is clearly a notion that regulation is needed to correct market failures that occur in a deregulated environment. In this regard the statements underlying the more recent regulatory initiatives reflect a clearly different approach to corporate regulation at the EU level than prior to the financial crisis. The political dynamic changed and allowed regulators to introduce initiatives that may not have been feasible before the crisis.

It is possible that the proposals regarding diversity issues can be understood in terms of political salience as well. Diversity is clearly an important issue and has become a matter of high political salience. Corporate governance regulation related to listed companies has provided an avenue to pursue this policy, with regulatory initiatives demonstrating a robust political response to concerns among the electorate regarding both diversity and corporate governance in light of the financial crisis. Yet it has not been demonstrated why diversity issues should be raised with respect to the constitution of boards of listed companies, in particular; rather than as a broader pursuit in the corporate environment[151].

The EU Parliament proposals to change the Commission proposal on amending the Shareholders Rights Directive also reflect the political salience of corporate governance. The

---

[149] *See* Laura Horn, *Corporate Governance in Crisis? The Politics of EU Corporate Governance Regulation*, 18 European L. J. 83 (2012).
[150] *See* OECD Corporate Governance Report, *supra* note 91.
[151] Belcredi & Ferrarini (2013), *supra* note 7, at 29.

Parliament initiatives included a number of matters that have received much public attention, such as management remuneration, corporate taxation and corporate social responsibility[152].

C. CONCLUSIONS ON THE CHARACTERISTICS OF THE COMPANY LAW ACTION PLAN

The Corporate Governance Green Paper was interpreted by many as suggesting that considerable amendments were underway with regard to the status quo of corporate governance in the EU[153]. Yet it seems that the political dynamic of the Company Law Action Plan is both less controversial and different than what was initially expected of the new initiatives.

It seems that, in fact, the Company Law Action Plan does not seek to materially affect the relationships between the traditional corporate constituencies – shareholders, management and employees. EU policy during the past decade has favoured shareholder-oriented corporate governance, which on a general level is not affected by the action plan. The proposals seek to facilitate shareholder engagement; there is no increase in protecting management from shareholder monitoring; and employee participation in corporate governance was not much enhanced as the initiatives for increased employee ownership remain muted. Overall, the Company Law Action Plan, in this regard, can be seen to be in line with a policy of favouring shareholders over managers or employees in matters pertaining to corporate governance and control.

However, the Company Law Action Plan does seek to address agency concerns related to the perceived "horizontal conflict of interests" between long-term investors and beneficial holders on the one hand and institutional investors and intermediaries on the other hand. In this regard, the Company Law Action Plan raises topical themes as these relationships have been subject to much research and debate over the past years[154].

The more important aspect to consider is how the Company Law Action Plan reflects the increased political salience of corporate governance at the international level and general political concerns in a post-crisis environment. It can be argued that corporate law and corporate governance regulation have been used as an avenue for political action unrelated to corporate governance concerns as such. There has been an increased pressure for political reactions to the financial crisis which has been channelled to corporate governance regulation due to the high political salience of corporate matters in the aftermath of the financial crisis. Also, listed companies have been subject to "regulatory capture" – i.e. they have already been subject to a regulatory framework that regulators have been able to take advantage of. Overall, corporate governance regulation has been an avenue for demonstrating political action for the electorate.

Mainly, however, the Company Law Action Plan is a reflection of the EU having strengthened its position as a source for corporate regulation at the cost of the member states. This trend emphasizes the importance of developing the characteristics of EU corporate governance regulation. There has been concern that the legislative procedures at the EU level are not satisfactory and that, generally, regulatory initiatives have been watered down due to political compromises. In many cases regulatory initiatives at the EU level have failed or resulted in inadequate compromises that are unclear or insufficient for effective and consistent

---

[152] *See* Parliament Amendments, *supra* note 124.
[153] *See, for example, supra* note 100.
[154] *See* Rodrigues (2011), *supra* note 67.

implementation at the national level[155]. In this respect it is interesting to note that some of the more controversial issues in the Corporate Governance Green Paper have been deleted from the Company Law Action Plan, and the proposed regulatory mechanisms have in many cases been limited to increased disclosure, rather than mechanisms transferring control rights among corporate constituencies. A further important aspect to consider is the ability of the EU to introduce regulatory mechanisms that can be applied throughout the varying institutional landscape of the EU. Both regulatory concerns and the effects of regulatory mechanisms vary depending on the corporate and institutional environment, including the structure of corporate ownership and the availability and quality of legal institutions for enforcement[156].

The issues above raise some concerns regarding the use of EU level regulation to pursue a competitive corporate governance framework, and, in any case, must be taken into account in developing EU level corporate governance regulation. Many scholars have observed these challenges with respect to EU regulation and proposed legislative processes where the regulatory impact is reached indirectly over time through soft law initiatives[157]. It seems that more work is needed with regard to the development of competitive policies, as well as the quality of the legislative processes at the EU level, and the instruments and regulatory tools available at the EU level.

V. Towards Federal Regulation of Corporate Governance in the EU?

Many aspects of corporate law have been regulated at the EU level over the past decades – yet corporate governance matters are often seen to be matters where there must be room for national regulation, and where the effects of EU regulation have been limited so far. The Company Law Action Plan has represented a new turn in this respect. Could the Company Law Action Plan form the basis for the development of a centralized system of corporate governance regulation in the EU?

A. The Legal Basis for Centralized Corporate Governance Regulation in the EU

The EU framework provides a legal basis for a more centralized system of corporate governance in the EU, if the political preconditions for such actions are met. The trend towards the centralization of regulation in the field of financial and corporate affairs and the increase of the role of the EU in that context[158] suggest that the EU can be an increasingly important source of corporate law and corporate governance regulation.

The legal basis for harmonization in the TFEU[159] has been seen to allow for further regulatory initiatives to be made at the EU level. The legal basis for corporate law harmonization is found in the provisions on the establishment of an internal market, as well as provision on the freedom of establishment for undertakings[160] and the prohibitions on restrictions on the

---

155 Expert Report 2012, *supra* note 12, at 4.
156 *See* Goergen (2007), *supra* note 45.
157 *See* Simon Deakin, *Reflexive Governance and European Company Law* (Centre for Business Research, University of Cambridge, Working Paper No. 346, 2007), *available at* http://ssrn.com/abstract=1002678; and Johnston (2009), *supra* note 26, at 240-242.
158 See Alex Warleigh-Lack, *"The European and the Universal Process"? European Union Studies, New Regionalism and Global Governance, in* HANDBOOK OF EUROPEAN UNION POLITICS 561 (Knud Jörgensen, Mark A. Pollack & Ben Rosamond, eds., 2007).
159 TFEU, *supra* note 85.
160 *Id.*, Article 49.

setting-up of agencies, branches or subsidiaries in member states. The European Commission can introduce company law directives, for example, in order to safeguard the rights of corporate constituencies throughout the EU[161]. The Commission could also introduce further measures to harmonize corporate governance regulation based on its authority to introduce directives to prevent restrictions affecting the establishment or functioning of the common market[162].

The EU Commission takes the view that there is a justification for EU intervention also in light of the subsidiarity and proportionality principles. The EU should generally intervene only to the extent such intervention provides better results than action by member states – EU action should also be limited to what is necessary and proportionate in order to achieve the objectives of the pursued policies. In the context of the proposal to amend the Shareholder Rights Directive the Commission has noted that the EU equity market has become a European and international market[163]. In this international corporate environment, the Commission argues, action by member states alone would provide uneven levels of transparency and investor protection resulting in "difficulties and costs" and a lack of "effective tools to protect their investments" in connection with cross-border holdings[164]. The EU Commission goes on to argue that, without EU regulation, there would be different rules across the member states with only partial and fragmented remedies[165].

The Commission nevertheless recognizes that the national level also has a role as a source for corporate governance regulation in the EU. In its proposal to amend the Shareholders Rights Directive, the Commission argues that member states should have flexibility in implementing principles regarding disclosure and transparency "in order to allow the norms to adequately fit into the distinct corporate governance frameworks"[166].

The Commission's initial proposals included mechanisms that went beyond disclosure rules, including requirements for approving remuneration policies and related party transactions by general meetings of shareholders. These propositions represented more robust interventions in corporate governance, and supports the view that the EU seeks a stronger role as a source of corporate governance regulation – at the cost of member states. The principles outlined in the Company Law Action Plan and in the proposal to amend the Shareholder Rights Directive can be seen as the initial steps of a formal basis for moving towards a more centralized system of corporate governance. As the investment environment has become international, the basis for investor protection must be increasingly uniform.

The EU has pursued a vigorous agenda of harmonization in the field of capital markets regulation over the past decade and even more so after the financial crisis. Indeed, the new European Commission has laid out a goal of achieving a capital markets union in its political program[167]. Importantly, some of the directives issued thereunder have considerable effects on corporate affairs – and on corporate law. The Transparency Directive, for example,

---

[161] *Id.*, Article 50(2)(g).
[162] *Id.,* Article 114.
[163] *Supra* note 3, at 6.
[164] *Id.*
[165] *Id.*
[166] *Id.* at 7.
[167] Jean-Claude Juncker, *Political Guidelines for the Next European Commission: 'A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Democratic Change'*, 27 June 2014, *available at* http://ec.europa.eu/about/juncker-commission/docs/pg_en.pdf

established a framework for periodic and on-going disclosure requirements for listed companies, whereas the Takeover Directive regulates the corporate steps that can be taken by a target company in a takeover situation, and sets redemption obligations and redemption rights for shareholders in different situations (including regulation on mandatory offers and squeeze-out as well as on the use of shareholder rights in concert). This development may provide the basis for further EU action in the field of corporate law and corporate governance as well. The EU Commission has justified intervention in the field of corporate governance with the internationalization of equity capital markets and the increase in cross-border share ownership. Thus the Commission may well take the view that it has a central role in regulating companies, the securities of which are subject to public trading, also as regards corporate law matters. Some of these initiatives may even be applied to non-listed companies, as conceptually it may not always be relevant in matters pertaining to corporate law and corporate governance whether a company is listed or not[168].

B. A MULTILEVEL SYSTEM OF CORPORATE GOVERNANCE REGULATION

The history of EU corporate law has demonstrated that the variation of corporate governance systems poses significant challenges for introducing uniform rules at the EU level. At the same time recent developments support a trend towards a larger role for EU level corporate governance regulation – albeit based on mechanisms with a limited impact on the existing relationships among corporate constituencies. In many cases, moreover, EU regulation seems to leave more latitude to national level regulation as well as to self-regulation than in the context of capital markets regulation, for example.

Instead of a corporate governance system based on "federal" style centralized codes, it is possible that in the field of corporate governance we will see a development of a multilevel system of corporate governance regulation. The EU regulatory framework has provided a new parallel avenue for regulatory change not subject to the same capture or dynamic as national regulation. Interest groups that are large and organized at the national level can be fragmented at the level of the EU, and new groups that have been too small at the national level to be able to organize can at the EU level have sufficient critical mass to overcome coordination problems, for example. Callaghan points out that the EU contributes to the development of a multilevel governance framework – also with respect to corporate governance regulation[169]. This can create new strategic opportunities for interest groups[170] while the EU institutional set-up allows for competing political coalitions to simultaneously advance different reforms thus limiting the possibility for interest groups to monopolize policy. This can promote a recognition of the acceptability of variety in corporate governance solutions in the EU, while allowing for EU level monitoring of corporate governance systems against increased entrenchment.

C. LEGAL STRATEGIES FOR EU CORPORATE GOVERNANCE REGULATION

To the extent that the EU maintains its position as a key source of corporate governance regulation it is important to focus on the competitiveness of the legal strategies adopted at the EU level. The Company Law Action Plan and the regulatory instruments issued thereunder demonstrate that there is much work to do in order to develop EU regulation in this regard.

---

[168] *See* EU Reflection Group Report, *supra* note 5, at 10.
[169] *See* Callaghan (2008), *supra* note 72.
[170] *Id.* at 10.

First, regulatory intervention should be adapted to the relevant institutional environment. Corporate governance regulation will have different effects depending on, for example, the structure of corporate ownership, and the quality of legal institutions. Certain initiatives in the Company Law Action Plan did not reflect the requirements of a concentrated ownership environment, for example. For the purposes of choosing appropriate legal strategies, it is important that the potential of abuse is addressed within the framework of the relevant institutional environment, and that solutions are introduced that appropriately address the characteristics of this environment.

Second, it has not been clearly demonstrated that a specific system of corporate governance is superior as such. No single structure of corporate ownership or control is necessarily superior to others, and different forms of corporate governance may be adapted to different environments and different types of enterprise[171]. The corporate environment is the result of historical economic and industrial developments and the structure of corporate ownership and control reflects these developments[172]. Corporate governance models that evolve in the context of an economy with heavy industry will be quite different from those in an economy dominated by trade or high technology industries, for example. Each system of governance has regulatory challenges and can be subject to abuse. Thus regulatory models should allow for and promote a variety of corporate governance solutions. The Company Law Action Plan does not seem to be particularly tailored for concentrated ownership structures, for example. The limited guidance on shareholder cooperation does not provide a basis for developing good governance in an environment with large shareholders, for example. Moreover, the proposals on regulating related party transactions allow for opportunistic behavior by minority shareholders. More focus is needed on developing instruments that address regulatory concerns while supporting prevalent corporate structures.

Third, regulation should facilitate the possibilities of corporate enterprise to adapt to changes in their environments. Change is a pervasive characteristic to the interaction between economic, political and corporate environments[173]. Technological changes affect the business and organizational environments of corporations, and it is vital that the organizational structures of business can be adapted to changing circumstances. At the same time, entrenchment has often been seen as a relevant factor in any corporate governance system. Regulatory models are likely needed to counter entrenchment and to facilitate corporate acquisitions and the transfer of control, for example. Indeed, the EU Reflection Group makes the same observation with regard to the goals of EU regulation stating that a "flexible legal framework can itself facilitate adaptation and organizational change and thus reveal itself to be an important factor to sustain competitiveness of European business"[174].

Fourth, the effects of political salience on regulatory initiatives must be recognized and addressed. The dynamic of regulatory development is different in circumstances of high

[171] *See* Masahiko Aoki & Gregory Jackson, *Understanding an Emergent Diversity of Corporate Governance and Organizational Architecture: An Essentiality-Based Analysis* 3 (SIEPR Discussion Paper 07-19, 2007), *available at* http://www-siepr.stanford.edu/repec/sip/07-019.pdf; Gilson (1992), *supra* note 51, at 175; MASAHIKO AOKI, TOWARD A COMPARATIVE INSTITUTIONAL ANALYSIS (2001).

[172] *See* Mark Roe, *Political Preconditions to Separating Ownership from Corporate Control*, 53 STAN. L. REV. 539 (2000); and Peter Högfeldt, *The History and Politics of Corporate Ownership in Sweden*, *in* A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS 517, 518-522 (Randall K. Morck, ed., 2005).

[173] Gilson (1992), *supra* note 51, at 175.

[174] EU Reflection Group Report, supra note 5, at 7.

political salience in that initiatives can be driven by unrelated political agendas. In such cases it may be advantageous to introduce soft law mechanisms, for example, that address immediate political concerns.

PART III

DISCUSSION AND CONCLUSIONS

CHAPTER 6

LAW AND POLITICS OF SUPRANATIONAL REGULATION: DYNAMICS OF EU CORPORATE GOVERNANCE REGULATION

This chapter builds on the previous parts of the study. It seeks to synthesize the findings of the study in the context of the development of EU corporate governance regulation. As emphasized throughout the study, the same EU regulation can have different and unintended effects in different jurisdictions – depending on the broader institutional variances throughout the EU. Also, the effects of the institutional structures of the EU, and the politics thereof, must be brought into the analysis regarding the development of regulation.

EU integration represents a model for coordinating interaction between economies and political systems in an internationalized environment. Understanding how supranational systems work and developing regulation at this level remains an important venture. The significance of EU level corporate governance regulation has been increasing in the years following the financial crisis. At the same time EU regulatory initiatives in this field have been subject to much criticism. It has been argued that the EU initiatives have not been adapted to corporate environments prevalent in the EU and have decreased the competitiveness of EU listed companies and the EU financial markets.

This study argues that the EU level will continue to be a significant source of corporate governance regulation, but that EU regulation must be designed to better adapt to the varied institutional environment across the EU. To that end a better understanding of the dynamics of EU policymaking remains important. This chapter analyzes EU policymaking in the context of corporate governance regulation and considers the implications for developing supranational regulatory initiatives.

I. SUPRANATIONAL POLICY-MAKING AND EU CORPORATE GOVERNANCE REGULATION

A. INTRODUCTION

The significance of EU level corporate governance regulation has been increasing in the years following the financial crisis. Corporate law and corporate governance have become focal areas of European integration[1]. International political trends have supported the concentration of regulatory initiatives to supranational political forums, including the EU[2]. The effects of

---

[1] *See European Commission, The EU Corporate Governance Framework, Green Paper, Brussels*, April 5, 2011, COM(2011) 164 final [hereinafter the "Corporate Governance Green Paper"], John Armour & Wolf-Georg Ringe, *European Company Law 1999-2010: Renaissance and Crisis* (ECGI Law Working Paper 175, 2011), *available at* http://ssrn.com/abstract=1691688, *and* Klaus Hopt, *Corporate Governance in Europe – A Critical Review of the European Commission's Initiatives on Corporate Law and Corporate Governance*, 12 N.Y.U. J.L. & BUS. 139 (2015).

[2] FINANCIAL REGULATION AND SUPERVISION, A POST-CRISIS ANALYSIS (Guido Ferrarini, Klaus Hopt & Eddy Wymeersch, eds., 2012), THE REGULATORY AFTERMATH OF THE GLOBAL FINANCIAL CRISIS (Elis Ferran, Jane Hill & John Coffee, eds., 2012), UNCTAD, Corporate Governance in the Wake of the Financial Crisis, Selected international Views (UNCTAD/DIAE/ED/2010/2), 2010.

this trend can be observed in the increased scope of EU regulatory initiatives in corporate matters, as well as in the more strict normative nature of many new EU initiatives[3]. In these circumstances it remains important to study EU harmonization efforts.

At the same time, EU corporate governance initiatives have been subject to much criticism[4]. Recent initiatives have been argued to decrease the competitiveness of publicly listed companies in the EU and consequently of the EU financial markets[5]. In responding to the initiatives, market participants have emphasized that corporate governance issues should be regulated primarily at the national level and that the EU should limit its involvement in this field[6]. However, some of this criticism may well be self-serving and it is not always clear that national regulation provides for superior results in an increasingly international corporate environment[7]. While national systems of corporate governance are adapted to the existing institutional environment, they may also reflect the entrenched interests of dominant corporate constituencies[8]. An emphasis on national level regulation can strengthen path dependence in regulation and serve to promote the national lock-in of corporate enterprise and weaken market integration. It has also been argued that with respect to corporate governance regulation there may be insufficient incentives for effective real world regulatory competition in the EU[9] so that positive harmonization and EU level corporate governance regulation cannot so easily be dismissed altogether.

Nevertheless, it seems clear that more work is needed with regard to the development of competitive policies, as well as the quality of the legislative processes, at the EU level[10]. In many cases, EU regulation has not been adapted to varied corporate environments across the EU, or initiatives have been subject to such political compromise that the effects of regulation remain limited[11]. It remains important to analyze EU policies with regard to corporate governance regulation with the aim to develop the legal strategies for, and the design of, EU corporate governance regulation.

---

[3] *See European Commission, Action Plan: European Company Law and Corporate Governance – A Modern Legal Framework for More Engaged Shareholders and Sustainable Companies*, COM(2012) 740/2, 12 December 2012.

[4] *See* Luca Enriques, *EC Company Law Directives and Regulations – How Trivial Are they*? 27 U. PA. J. INT. ECON. L. 1 (2006), Luca Enriques & Matteo Gatti, *The Uneasy Case for Top-Down Corporate Law Harmonization in the European Union*, 27 U. PA. J. INT. ECON. L. 939 (2006), Hopt (2015), *supra* note 1, at 21-22.

[5] *European Commission, Report of the Reflection Group on the Future of EU Company Law*, 2011, *available at* http://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en.pdf [hereinafter the EU Reflection Group Report], at 10.

[6] Hopt (2015), *supra* note 1, at 167-169.

[7] *See* Jean-Michel Josselin & Alain Marciano, *Introduction: The Economics of the Constitutional Moment in Europe*, *in* THE ECONOMICS OF HARMONIZING EUROPEAN LAW 1, 9 (Alain Marciano & Jean-Michel Josselin, eds., 2002).

[8] *See* Guido Ferrarini & Geoffrey P. Miller, *A Simple Theory of Takeover Regulation in the United States and Europe* 15 (New York University Law and Economics Working Paper 197, 2009), *available at* http://lsr.nellco.org/nyu_lewp/197.

[9] ANDREW JOHNSTON, EC REGULATION OF CORPORATE GOVERNANCE 177, 182 and 212-213 (2009).

[10] DERMOT MCCANN, THE POLITICAL ECONOMY OF THE EUROPEAN UNION 85 (2010).

[11] *See* Enriquez (2006), *supra* note 4.

B. POLICY-MAKING IN A SUPRANATIONAL ENVIRONMENT

The dynamics of policy-making and regulatory processes are complex – particularly in a supranational context. A hard-defined "political system"[12], the EU provides a particularly interesting platform with respect to policy-making. The political framework of the EU cannot merely be seen as an intergovernmental system, far less as a framework of agreements whereby certain sovereign functions have been delegated for purposes of efficiency[13]. With the evolution of European integration the EU has developed into a political system in its own right[14]. The EU institutions affect how agendas are set and how policy can be pursued through the political system. At the same time, the EU and national levels interact and provide parallel avenues for regulatory action.

On a general level, policy and regulation must be understood and studied in their economic and political context. Regulatory action (or inaction) is the result of political processes with their own dynamics, including the effects of interest groups, political constituencies and the institutional political structure. The economic theory of regulation suggests that regulation is driven by a "market for regulation" where political actors trade regulatory benefits for resources and where regulation can be captured by dominant interest groups[15]. In this model the redistributive effects of regulation are emphasized. Indeed, it is important to recognize that economic regulation will of course affect the distribution of wealth in the form of the reallocation of risks or opportunities, for example. It is rarely the case (if ever) that regulation would address "market failures" in a pareto-optimal manner[16]. Dominant, well organized constituencies will be able to benefit from regulatory intervention. Single political interests need not dominate policy, however, as utility maximization by political entrepreneurs is still likely to result in regulation that takes into account some concerns of other political coalitions as well[17]. Industrial and political developments can affect the relative bargaining power of political constituencies resulting in changing policy agendas and new regulatory initiatives.

These general dynamics also apply to policy-making at the supranational level. However, the interplay between national and supranational levels and the characteristics of the institutional environment must also be taken into consideration when studying supranational policy and regulation. In some cases supranational regulation may trump national rules, but often the different regulatory levels provide parallel and sometimes competing avenues for interest groups to pursue their interests. Overall, the introduction of the EU framework has introduced a parallel regulatory framework to national regulation[18]. Constituencies can pursue regulatory agendas through both the national and the EU regulatory frameworks and in many instances the EU institutional framework has been said to have resulted in a multilevel system of governance in the EU[19]. The dynamic of policy-making depends on the type of policies in

---

[12] SIMON HIX & BJÖRN HOYLAND, THE POLITICAL SYSTEM OF THE EUROPEAN UNION, 3RD ED., 1-2 and 12-16 (2011); *see also* Mark A. Pollack, *Theorizing EU Policy-Making*, *in* POLICY-MAKING IN THE EUROPEAN UNION, 6TH ED. 15, 27 (Helen Wallace, Mark A. Pollack & Alistair R. Young, eds., 2010).
[13] Pollack (2010), *supra* note 12, at 16-21.
[14] *Id.* at 27.
[15] *See* George Stigler, *The Theory of Economic Regulation*, 6 BELL J. OF ECON. 2, 3-21 (1971).
[16] ANTHONY I. OGUS, REGULATION, LEGAL FORM AND ECONOMIC THEORY 59 and 72 (1994).
[17] *See* Samuel Peltzman, *The Economic Theory of Regulation After a Decade of Deregulation* 13 (Brookings Papers on Economic Activity, 1989); *see also* Gary Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q´LY J. OF ECON. 371 (1983).
[18] *See* LIESBET HOOGHE & GARY MARKS, MULTI-LEVEL GOVERNANCE AND EUROPEAN INTEGRATION (2000).
[19] *See* Helen Callaghan, *How Multilevel Governance Affects the Clash of Capitalisms* (MPIfG Discussion Paper 08/5, 2008), *available at* www.mpifg.de (publications, discussion papers).

question – whether regulatory or distributive, for example[20]. Depending on the policy at hand the scope of EU authority will differ, as will the dynamics of agenda-setting and decision making regarding regulatory intervention at the EU level. The alliances, political and regional, may vary depending on the matters at hand.

The authority and characteristics of the supranational regulatory institutions are also key factors with respect to how policies are formed. The authority of the supranational institutions may be narrowly defined, or they may have structures suited for certain policy-regimes better than others. Altogether, the EU has provided an opportune avenue for regulatory policy-making for responding to emerging changes in the international economy[21] with an increased need for coordinating standards among private actors on a cross-border basis. The EU model has been successful in combining transnational standards with national differences[22]. The institutional structure, with negotiation processes supported by the EU legal system, but with less immediate parliamentary pressures, has also been deemed an important factor in this regard[23]. Both national policy-makers and industrial interest groups have found the EU as an opportune avenue to pursue policy and change in the industrial and economic systems of EU member states. The "regulatory mode" of the EU[24] has been well-adapted for pursuing policies related to corporate regulation, which at the national level may be entrenched and based on historical industrial structures.

It has been pointed out that the influence of interest group can differ at the national and EU levels. For example, Ferrarini & Miller argue that the interests of corporate insiders remain strong at the national level[25]. With respect to takeovers, for example, interest groups representing management, labour and community groups are likely to advocate for rules that increase the threshold for takeovers[26]. At the international (or "federal") level, however, corporate insiders may not have the same relative advantage over the interests of bidders (and minority shareholders) who may better be able to organize themselves on an international basis. Empirical studies from the United States support this analysis[27]. The preference for regulatory competition (national regulation) or harmonization (EU regulation) may also be driven by how the relevant constituency can best promote its interest – in relative terms. Constituencies with considerable sunk costs and a high threshold for corporate mobility may not be able to take advantage of the freedom of establishment. To prevent competitors from taking advantage of more competitive regimes they would opt for EU level harmonization setting similar rules throughout the EU that would cater to existing industrial standards and

---

20 Helen Wallace & William Wallace, *Overview: The European Union, Politics and Policy-Making, in* HANDBOOK OF EUROPEAN UNION POLITICS 339, 340-344 (Knud Erik Jorgensen, Mark A. Pollack & Ben Rosamond, eds., 2007).

21 Helen Wallace, *An Institutional Anatomy and Five Policy Modes*, 69, 95 *in* POLICY-MAKING IN THE EUROPEAN UNION, *supra* note 12.

22 *Id.*

23 *Id.; see also* Simon Hix, *The European Union as a Polity (I),* 141, 145 and 152 *in* HANDBOOK OF EUROPEAN UNION POLITICS, *supra* note 20.

24 Wallace (2010), *supra* note 21.

25 *See* Ferrarini & Miller (2009), *supra* note 8.

26 *See* Roberta Romano, *The Political Economy of Takeover Statutes*, 112 VIRGINIA L.R. 111 (1987).

27 See Brian R. Cheffins, Steven A. Bank & Harwell Wells, *The Race to the Bottom Recalculated: Scoring Corporate Law Over Time* (ECGI Law Working Paper 261, 2014), available at http://ssrn.com/abstract_id=2475242, Lucian A. Bebchuk & Assaf Hamdani, *Federal Corporate Law: Lessons from History* (Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series 8-5-2006, 2006), available at http://lsr.nellco.org/harvard_olin.

structures[28]. Constituencies with lower costs for relocating, on the other hand, will lobby for national regulation and regulatory competition, as they can move their operations to jurisdictions with more favourable regulation, for example[29].

A further important aspect is how regional differences affect regulatory processes - in addition to the more traditional interest group dynamics. With respect to corporate governance, for example, policy has generally focused on the relationships among investors, management and employees. The dynamics of these relationships are quite different across the EU increasing the complexity of pursuing policy at the EU level. In connection with key regulatory initiatives there have been significant cleavages in traditional politically defined interests at the EU level that have been based on regional differences in corporate governance systems. This has been the case, for example, with respect to support for the Takeover Directive in the EU parliament[30].

The institutional structure of the EU also affects policy-making. The dynamics of agenda-setting and decision-making in the key institutions, including the Council, the Commission and the EU Parliament, have their own dynamics that affect regulatory processes and outcomes. Also, the EU institutions do not only reflect the interests of national constituencies, but drive their own agendas as well. For example, the EU institutions may have an interest in increasing their overall influence as such. The different EU bureaucracies may be able to identify potential political alliances when promoting new regulatory initiatives[31] to ensure that the initiatives are acceptable to key political and industry actors. It is possible that the interests of industry representatives and governments vary among jurisdictions depending on the applicable economic structures, and that different alliances would be formed from time to time with regard to political and lobbying efforts. These efforts may overshadow the analytical advancement of the structure and design of regulation.

C. REGULATORY IMPLICATIONS

Developing policies and introducing regulation in the field of corporate governance at the EU level raises complex issues. A number of EU initiatives have been specifically criticized for failing to take into account the institutional landscape in which regulation is supposed to be applied[32]. Also, certain EU initiatives have failed to be introduced altogether as they challenged key interests of politically dominant constituencies in the EU[33].

With regard to corporate governance, there has at times been tension between regions with different corporate governance systems that transcend traditional political cleavages. The introduction of EU level regulation that is perceived to conflict with complementary

---

[28] Roger Van den Bergh, *Regulatory Competition or Harmonization of Laws? Guidelines for the European Regulator*, *in* THE ECONOMICS OF HARMONIZING EUROPEAN LAW, *supra* note 7, at 27, 37-38.
[29] *See* Jacques Pelkmans & Jeanne-Mey Sun, *Regulatory Competition in the Single Market*, 33 J. OF COMMON MARKET ST. 67 (1995).
[30] THE POLITICAL SYSTEM OF THE EUROPEAN UNION, *supra* note 12, at 214-216, *see also* Helen Callaghan & Martin Höpner, *European Integration and the Clash of Capitalisms: Political Cleavages over Takeover Liberalization*, 3 COMP. EUR. POLITICS 307 (2005).
[31] McCann (2010), *supra* note 10, at 117.
[32] *See* Marc Goergen, *What Do We Know about Different Systems of Corporate Governance?* (ECGI Finance Working Paper 163, 2007), available at http://ssrn.com/abstract_id=981531; *see also* Arman Khachaturyan, *The One-Share-One-Vote Controversy in the EU*, 8 European Bus. Org. L. Rev. 335 (2007).
[33] *See* Enriquez (2006), *supra* note 4.

institutions has raised concerns that have affected political alliances and party loyalties at the EU level[34]. These concerns might be alleviated by adopting legal strategies adapted, as far as possible, to the existing institutional environment while retaining set regulatory goals. The question arises as to whether the legal strategies and the design of regulation could be developed at the EU level to better take into account the characteristics and challenges of a supranational regulatory environment. Another question is whether the political dynamics of corporate governance regulation allow for developing legal strategies in this manner.

The form and design of legal intervention are key factors for the efficient enforcement of policy. Strategies can vary from specific rules or standards to regulatory frameworks based on contractual arrangements. Enforcement of legal strategies can be based on private actions (court systems) or on public authorities, such as regulatory agencies. Different legal strategies may be required to ensure that legal intervention has the desired effects in different institutional environments. For example, the enforcement of certain legal strategies may depend on the quality of available court systems. Legal strategies are also likely to vary depending on the applicable institutional environment so that they address the concerns and interests of dominant constituencies.

Developing legal strategies in a supranational framework, such as the EU, provides for special challenges as the institutional environment varies across affected jurisdictions. Where one strategy may be appropriate in some EU member states due to the structure of corporate ownership, for example, another strategy may be called for in other jurisdictions with a different corporate environment. The effects of EU level regulation differ across the affected jurisdictions depending on the relevant applicable market structures and the broader institutional environment. In some cases the effects have been contradictory to the stated goals of EU regulation[35]. There is also only a limited set of regulatory mechanisms available at the EU level, and both the implementation and the interpretation of EU regulation can vary across the member states[36]. The EU also largely relies on the member states to provide mechanisms for enforcing the regulation originating at the EU level. The design of EU regulation and the choice of regulatory mechanisms are relevant in this regard, and may need to be better adapted to different institutional environments.

The EU political institutions and the political processes for EU regulation pose their own challenges for pursuing regulatory initiatives at the EU level. Regulation is the result of political processes and the efforts of affected constituencies pursuing their interest through the markets for regulation. In this respect, the study recognizes that corporate law can be expected to reflect the institutional power of dominant corporate constituencies[37]. However, the EU framework has added considerable complexity to the political dynamic of regulatory development. The EU process for introducing regulation has its own characteristics with respect to interest group input and political dynamics of the legislative process[38]. The EU political institutions provide an alternative and additional framework to national institutions with respect to interest group input and the regulatory markets. The agendas and alliances of

---

[34] *Supra* note 30.

[35] John C. Coates IV, *Ownership, Takeovers and EU Law: How Contestable Should EU Corporations Be?* 12 (ECGI Law Working Paper 11/2003), available at http://ssrn.com/abstract=424720.

[36] Alasdair R. Young, *The European Process in Comparative Perspective*, 45, 61-63 in Wallace, Pollack & Young (2010), *supra* note 12.

[37]John Armour, Henry Hansmann & Reinier Kraakman, *What is Corporate Law*?, 1, 32, in KRAAKMAN ET. AL., THE ANATOMY OF CORPORATE LAW – A COMPARATIVE AND FUNCTIONAL APPROACH (2nd ed., 2009).

[38] *See* Callaghan (2008), *supra* note 19.

affected constituencies and interest groups may differ across the EU creating a challenging political dynamic to be taken into account when considering feasible strategies for regulatory intervention at the EU level.

In summary, at the EU level it is not sufficient to address specific policy concerns within a given institutional setting. In fact, developing EU level legal strategies poses at least two different kinds of challenges that vary from regulatory intervention at the national level. First, the effects of EU level regulation vary depending on the institutional environment in different member states and, second, the political processes related to the enactment of EU regulation create a multilevel governance framework that affects how interest groups can best promote their agendas through regulatory intervention. These factors must be taken into account also when considering the development of EU corporate governance regulation and different mechanisms for regulating control transactions.

This chapter will assess the legal strategies used at the EU level with respect to corporate governance regulation, and consider how these strategies might be developed to better reflect the complex regulatory environment. I first briefly outline a typology of strategies and then propose further considerations and amendments based on a political approach to corporate governance regulation. I will then also consider the premises for a qualitative framework for developing EU corporate governance policy and regulation.

II. CORPORATE GOVERNANCE AND THE EU

In order to understand the dynamics of EU corporate governance regulation, it is important to first reflect on the nature of corporate governance and the economic and policy implications of corporate governance regulation. To highlight the challenges that face EU regulatory initiatives in this regard, this chapter will discuss the nature of corporate governance and how corporate governance relates to the institutional environment in an EU context. The study will then turn to the political and legislative dynamics of EU regulation, and the evolution of EU policies on corporate governance.

A. A VARIED CORPORATE ENVIRONMENT

The characteristics of the corporate and financial environments vary across the EU. Factors resulting in these differences include differences in industrial structures, the openness of the economy, and the structure of the financial system, for example. As regional differences have emerged they have been strengthened as complementary institutions arise to address issues related to the relevant corporate environment.

One of the significant factors differentiating companies with respect to corporate governance is the prevalent structure of corporate ownership. The level of concentration of ownership and the type of shareholders affect have a significant effect on the type of corporate governance systems that emerge to address relevant concerns related to each type of ownership. Dispersed ownership among large companies is more common in the United Kingdom and, to a lesser extent, in the Netherlands, while it has been rare elsewhere in the EU[39]. The type of dominant owners has also varied and included governments, families and financial institutions[40]. Corporate governance systems have evolved nationally to reflect the concerns that have arisen

[39] Torben Pedersen & Steen Thomsen, *European Patterns of Corporate Ownership: A Twelve-Country Study*, 28 J. OF INTERNL. BUS. ST. 759, 767 (1997).
[40] *Id.*

in each case. In dispersed ownership systems the relationship between management and shareholders has typically been of greater interest, while in countries with concentrated ownership the position of minority shareholders in relation to controlling shareholders may be of particular interest.

There has been considerable resistance to a number of EU initiatives that relate to company law and corporate governance, such as the proposal for the Fifth Company Law Directive[41], the Takeover Directive, and the one-share-one-vote initiative[42], for example. Distinct company law and corporate governance systems have developed at the national level in the EU member states, and introducing change has been met with political resistance as nationally established institutions and the interests of dominant constituencies have been challenged. It has been noted that there has been less resistance against the introduction of new regulation when there are no national level structures or interest groups that are immediately challenged[43].

It has proved challenging to introduce EU level regulation in this varied environment. The application of the same regulatory mechanism can have different results across a varied institutional landscape such as the EU[44]. Specific regulatory mechanisms may not be adapted to prevailing systems of corporate governance which may lead to unintended results. The structure of corporate ownership will affect the relevance of different regulatory mechanisms, as will the quality of enforcement, for example. This can disenfranchise specific governance models and prevent the development of a level playing field. Rules that are effective in one type of environment may be less relevant in another corporate environment. For example, regulating the duties of the board of directors (especially in takeover situations) is important in the context of dispersed ownership, while the same regulation has less relevance in a concentrated ownership environment. Also, regulation intended to decrease control enhancing mechanisms introduced in the EU Takeover Directive have been argued to have the opposite potential as controlling shareholders would have ensured their control rights would not be challenged by new regulatory initiatives[45].

B. THE COMPLEX NATURE OF CORPORATE GOVERNANCE

Different corporate constituencies have often voiced their frustration over new initiatives for EU corporate governance regulation. Compliance requirements have been deemed costly and unnecessary, and the EU framework a negative factor for the competitiveness of EU listed companies[46]. In such criticism corporate governance regulation is sometimes seen as an endogenous burden for companies that increases administrative costs while providing little added value. Indeed, regulation is not cost-neutral and it is not always clear that legislators are able to produce regulation with an optimal design – often the opposite is the case, as has been

---

41 *Amended Proposal for a Fifth Directive Founded on Article 54(3)(g) of the E.E.C. Treaty Concerning the Structure of the Public Limited Companies and the Powers and Obligations of Their Organs,* 26 O.J. EUR. COM. (No. C240) 2 (1983) [hereinafter the Fifth Company Law Directive Proposal]; *see* Johnston (2009), *supra* note 9, at 139-139.

42 *See* Khachaturyan (2007), *supra* note 32.

43 Armour & Ringe (2011), *supra* note 1, at 27.

44 Marc Goergen, Marina Martynova & Luc Renneboog, *Corporate Governance Convergence: Evidence from Takeover Regulation* 29 (ECGI working paper No. 33/2005), *available at* http://ssrn.com/abstract=709023.

45 *See* Coates (2003), *supra* note 35.

46 *See* Enriques & Gatti (2006), *supra* note 4; *see also Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Better regulation for better results* - *An EU agenda*, COM(2015) 215 final, Strasbourg, May 19, 2015.

argued with regard to many EU initiatives[47]. However, corporate governance is complex, of course, and the function or purpose of new regulation is sometimes overseen.

In its simplest form corporate governance can be understood in an organizational context as "the system by which companies are directed and controlled"[48] with the aim of reducing transaction costs. Similarly, corporate law could be viewed as a default framework for the legal organization of business enterprise[49]. The function of corporate governance would be to address the collective action problems of various corporate claimholders and to reduce "the scope for value-reducing forms of opportunism among different constituencies"[50].

However, corporate governance is not only related to the organizational aspects of enterprise. The distributional aspects of corporate governance are a significant factor in this regard. The basis for how the revenue from the enterprise is distributed will have an effect on the willingness of corporate constituencies to make investments in the corporate enterprise. In this respect the notable definition by Shleifer & Vishny provides that "corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment"[51]. Shleifer& Vishny emphasize that production capital is actually specified so that it is committed to the enterprise (resulting in sunk costs). As different constituents consider firm-specific investments of capital or labor resulting in such costs, there must be sufficient assurance that they will be repaid. Corporate governance mechanisms are intended to provide that assurance[52]. Pursuant to the definition above the goal of the corporate governance mechanisms is to provide a basis for an optimal balance in the terms and conditions of different types of contributions of production capital (equity, debt, labor etc.) from time to time. The Shleifer & Vishny definition suggests that corporate governance arrangements are much like contractual arrangements or covenants that are negotiated among the parties and affected by the risks and returns involved.

However, corporate governance is a more complex phenomenon not easily defined based on a purely contractual approach. At best, the theories related to costs of contracting suggest that the implicit contracts underlying the relationships between corporate constituents are incomplete[53]. Corporate governance provides the means and mechanisms by which potential conflicts of interest among different corporate constituencies are resolved. It is important to recognize, however, that the dynamics of corporate governance can change. Corporate constituents can seek to renegotiate these contracts if their bargaining power increases over time with each party seeking to increase its stake from the income of the enterprise[54].

---

[47] *See* Luca Enriques, *Company Law Harmonization Reconsidered: What Role for the EC* (ECGI Law Working Paper No 53/2005), *available at* http://ssrn.com/abstract=850005.

[48] Report of the Committee on the Financial Aspects of Corporate Governance, 1992, at 2.5, *available at* http://www.ecgi.org/codes/documents/cadbury.pdf.

[49] Armour, Hansmann & Kraakman (2009), *supra* note 37, at 2.

[50] *Id.*

[51] Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. OF FINANCE 737, 737 (1997).

[52] *Id.* at 738.

[53] *See* Philippe Aghion & Patrick Bolton, *An Incomplete Contracts Approach to Financial Contracting*, 59 R. ECON. STUDIES 473 (1992).

[54] Manuel A. Utset, *Towards a Bargaining Theory of the Firm*, 80 CORNELL L. REV. 540, 609 (1995).

Corporate Governance as a Framework for Bargaining

Importantly, it is also possible to approach the corporation and corporate governance as a framework for continuous or at least recurring bargaining among self-interested actors with varied interests who can obtain benefits from mutual cooperation[55]. Bargaining occurs in, and is affected by, the broader institutional environment, involving market institutions and processes, the industrial and political environment and formal and social norms[56]. This approach recognizes that governance of the corporation does not occur in a vacuum, and is affected by the relevant institutional environment that participants interact with, and based which participants can also form coalitions for increased bargaining power[57]. Bargaining can take the form of explicit or implicit contracts that parties may seek to renegotiate from time to time as their relative bargaining power evolves. The relative bargaining power among the corporate constituencies can change as a result of technological or industrial changes, for example, or through political developments and the introduction of new regulation. Bargaining does not need to be direct but corporate constituencies can affect the internal relationships through the political system, for example. Importantly, this approach recognizes the legal and economic aspects of corporate governance, but incorporates the political aspects of corporate governance to the definition.

A relevant prerequisite for bargaining is the fact that contracts are necessarily incomplete, as discussed above, and it is generally not possible to fully regulate the relationships among corporate constituencies *ex ante*. When an investor has made a significant firm-specific investment (be it a shareholder, debt holder, manager or employee) it is difficult to withdraw the investment and it becomes less liquid. Once an equity investment is made, for example, it may not be possible to withdraw it and the investor is dependent on the continued performance of other constituencies. Similarly, an employee will be more dependent on the specific corporation once the employee has invested in firm-specific skills that may be difficult to take elsewhere. Other constituencies may look to take advantage of this and attempt to renegotiate the terms of their respective investments as their relative bargaining power changes. Investors will be aware of this risk, of course, and require *ex ante* guarantees to protect their initial investment[58]. However, as contracts are necessarily incomplete (and as the alternatives available to the investors will likely have the same characteristics in an environment of incomplete contracts) there will be room for such renegotiations[59].

The structure of corporate finance and the corporate governance framework provide for the building blocks for bargaining. In this context, the corporation and corporate finance can be approached from the perspective of financial contracting[60]. In simple terms financial contracting in the corporate context can be seen as the understanding between the

---

[55] *See* MASAHIKO AOKI, TOWARD A COMPARATIVE INSTITUTIONAL ANALYSIS (2001), John C. Coffee, *Unstable Coalitions: Corporate Governance as a Multi-Player Game*, 78 GEO L. J. 1495 1989-1990 and Utset, *supra* note 54.

[56] Masahiko Aoki & Gregory Jackson, *Understanding an Emergent Diversity of Corporate Governance and Organizational Architecture: An Essentiality-Based Analysis* 3 (SIEPR Discussion Paper 07-19, 2007), *available at* http://www-siepr.stanford.edu/repec/sip/07-019.pdf.

[57] See Aoki (2001), *supra* note 55, at 287-291; Coffee, *supra* note 55; *see also* PETER GOUREVITCH & JAMES SHINN, POLITICAL POWER AND CORPORATE CONTROL (2005).

[58] *See* Luigi Zingales, *Corporate Governance* 16 (NBER Working Paper 6309, 1997), *available at* http://www.nber.org/papers/w6309 .

[59] *Id.* at 3.

[60] *See* OLIVER HART, FIRMS CONTRACTS AND FINANCIAL STRUCTURE 8, 118-120 (1995).

entrepreneur with an idea but no funds and the investor with funds but no idea[61]. The structure of corporate finance and the corporate governance of the corporation are the result of bargaining between these actors. In financial contracting theory the entrepreneur negotiates cash flow and governance rights with the providers of financing[62]. Entrepreneurs and investors can agree on the allocation of control rights and cash-flow rights with the aim of finding the best outcome to meet the specific requirements and priorities of each party. The different priorities of the actors and their relative valuation of control and cash-flow rights provide a basis for the bargaining over how cash-flow and governance rights are allocated between them. As discussed, different types of financial instruments, i.e. equity, debt and convertibles, are the basic the building blocks of corporate finance and corporate governance[63]. The structure of corporate finance sets the framework for ex-post bargaining over control. Debt-financing generally allows the entrepreneur to maintain control, for example. However, higher levels of debt increase the risk of default with the result, typically, that control will be passed on to the investors. Equity-financing, on the other hand, generally provides control to the investors. Financial instruments with contingent control rights, such as convertible debt, provide a further model of allocating governance rights in that control is transferred upon a triggering event typically linked to the performance of the enterprise.

Corporate governance can thus be approached as a broad framework for on-going bargaining[64] among corporate constituencies over the terms of corporate finance. Corporate governance regulation, then, covers a broader scope of regulation than provisions in corporate law that directly apply to the corporate rights and obligations of stakeholders and include, for example, tax laws, employee regulation and contract law. The regulation of legal institutions, such as commercial courts and agencies, are also relevant, as enforcement mechanisms are a key factor in legal strategies related to corporate governance. Finally, corporate governance cannot be understood without reference to the economic and political systems that create the framework for bargaining for the relevant constituencies.

Bargaining and Politics

New legal regulation can also be seen as a mechanism for changing the original corporate governance framework. Corporate constituencies are also interest groups that can use political avenues to pursue corporate interests, and changes in regulation can be seen to reflect changes in the relative bargaining power of these constituencies. The relationship between entrepreneurs and investors will be renegotiated, in part, through political and regulatory intervention as the political bargaining power of these constituencies evolves. Corporate governance regulation can be expected to reflect the interests of politically dominant constituencies. Different constituencies have different requisites for pursuing their interests in this regard, however[65]. Theories on political coordination suggest that small interest groups with similar interests overcome coordination problems to sufficiently promote their interests. Groups of large shareholders in an environment of concentrated ownership have often been

[61] Oliver Hart, *Financial Contracting* 1 (NBER Working Paper 8285, 2001) *available at* http://www.nber.org/papers/w8285.

[62] *Id.* at 1-2, 10-12, *see also* Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision,* 125 YALE L.J. 560 (2013).

[63] *See* Hart (2001), *supra* note 61.

[64] Aoki (2001), *supra* note 55, see also Peter Nobel, *Stakeholders and the Legal Theory of the Corporation*, *in* PERSPECTIVES IN COMPANY LAW AND FINANCIAL REGULATION 176 (Michel Tison, Hans de Wulf, Christoph van der Elst & Reinhard Steennot, eds., 2009).

[65] *See* MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION (1971).

identified as this type of constituency. On the other hand, the interests of large interests groups with similar interests are generally reflected through the political system. Labour interests, for example, have been argued to be largely represented through these avenues. However, large interest groups with dissimilar interests may be more vulnerable than others as they may face disproportionate coordination costs. Minority shareholders, for example, may have sufficiently diverging agendas and too small financial interests to allow for efficient coordination. The interests of these constituencies, then, may require special attention.

Changes in bargaining power may reflect changes in the overall political economy. As industrial structures develop and the political economy evolves the initial outcome of bargaining may become sub-optimal. In other words, the original allocation of control is no longer value maximizing from a property rights perspective. At the same time, the relative bargaining power of the corporate constituents may change. As a consequence, the framework for feasible corporate governance outcomes changes. Technological change can affect the relative importance of different types of firm-specific investments in this regard. For example, the increase of the importance of human capital in relative terms has been referred to in many instances. The outcome of the dispute between the new owners and the manager and former owner of the advertising agency Saatchi & Saatchi has been referred to as the case in point in this regard[66]. As the new shareholders did not accept the salary requirements of the former chairman he left the company together with others to set up a competing enterprise – and took a significant portion of the company's assets with them in the form of the human capital.

It has been argued that change is the central characteristic of the system involving the interaction between economic, political and corporate environments[67]. Technological change affects the business and organizational environments of corporations, and it is vital that the organizational structures of business can be adapted to changing circumstances. Corporate acquisitions and the transfer of control are important elements in this respect. The transfer of control can be seen as a process whereby access to the corporate assets is transferred to a party that, due to technological or other changes, for example, can use them more efficiently and can give them a higher value[68]. It is therefore important that the transfer of control is appropriately facilitated, but as discussed, the pervasiveness of control is a central characteristic of corporate governance. Creating incentives for changing the structure of corporate ownership may consequently be as important as trying to regulate the concerns related to currently dominating structures of corporate ownership.[69] Moreover, many of the governance mechanisms based on monitoring by external parties are not as effective as has been assumed. This suggests that it remains important to continue to develop different approaches to corporate governance regulation.

On a general level parties should have freedom of contracting with respect to different corporate governance solutions and it is generally not warranted to promote specific structures of governance or ownership through regulation. However, it is also the case that the outcomes of bargaining are not necessarily optimal or efficient – especially in the longer term as the political economy evolves. Also, in many cases bargaining is carried out in "an institutional,

---

[66] *See* Raghuram G. Rajan & Luigi Zingales, *The Governance of the New Enterprise, in* CORPORATE GOVERNANCE, THEORETICAL & EMPIRICAL PERSPECTIVES (Xavier Vives, ed., 2000).
[67] Ronald J. Gilson, *The Political Ecology of Takeovers: Thoughts on Harmonization of the European Corporate Governance Environment*, 61 FORDHAM L. REV. 161, 175 (1992).
[68] *Id.* at 164.
[69] *Id.* at 174-175.

legal, standardized framework"[70] that shapes the solutions and may or may not coincide with the optional structures for the enterprise in question. Political considerations also have a considerable impact in this respect. The ex-post bargaining process is therefore very important. Moreover, it has been emphasized that as the corporate environment evolves organizations must have the ability to adapt, in which context the transfer of control is a key element. However, due to the characteristics of corporate governance and deficiencies in many corporate governance mechanisms corporate control may be entrenched so that control is not necessarily transferred when it would be efficient. Consequently, it may well be justified to continue to consider new regulatory concepts and mechanisms.

The EU provides a forum for regulatory changes discussed above. Relevant questions that arise in this context include how the EU institutions are attuned to dealing with these types of policy issues, and how the structure of the EU institutions affects regulatory outcomes.

C. CORPORATE GOVERNANCE AND THE INSTITUTIONAL ENVIRONMENT

Corporate governance and the structure of corporate ownership are closely related to industrial and historical conditions, and reflect the development of economic, political, legal and historical conditions[71]. The model of ownership and governance that has developed in an economy with heavy industry requiring considerable capital outlays and untrained labor could be expected to differ from the model that has evolved in an economy based on services or products requiring firm-specific investments of skilled labor, for example. Industrial and historical developments may not in all cases support a specific structure of corporate ownership[72]. The systems of corporate ownership and corporate governance are likely to have developed based on the requirements of existing circumstances. Roe argues, for example, that in countries with strong labor institutions there is likely to be pressure for more corporate governance institutions that favor employees and less for institutions that support the interests of shareholders[73]. Companies are likely to be encouraged to expand to secure employment even at the cost of profitability, for example, and to avoid down-sizing as well as not to take disruptive risks[74]. In this environment the institutions needed for dispersed ownership to flourish are not present, whereas a controlling shareholder, on the other hand, would be in a relatively better position to bargain over surplus and to resist political pressures[75].

The importance of historical development and path dependence has been emphasized in the legal literature on corporate governance[76]. Once a given structure has been established, it is

---

[70] *See* Bruno Deffains & Dominique M. Demougin, *Governance: Who Controls Matters* (SFB 649 Discussion Paper No 53, 2006), *available at* http://hdl.handle.net/10419/25136.
[71] Randall K. Morck & Lloyd Steier, *The Global History of Corporate in Governance – An Introduction, in* A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS 517, 518-522 (Randall K. Morck, ed., 2005); *see also* Peter Högfeldt, *The History and Politics of Corporate Ownership in Sweden*, *in* A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS, *supra,* at 517*; and* Paul Davies et al., *Beyond the Anatomy*, 305, in Kraakman et. al. (2009), *supra* note 37.
[72] *See* Mark Roe, *Political Preconditions to Separating Ownership from Corporate Control*, 53 STAN. L. REV. 539 (2000); *see also* Magnus Henrekson & Ulf Jakobsson, *The Swedish Corporate Governance Model: Convergence, Persistence or Decline?,* 20 CORPORATE GOVERNANCE: AN INTERNATIONAL REVIEW 212 (2012).
[73] Roe (2000), *supra* note 72, at 18.
[74] *Id.* at 18-19.
[75] *Id.* at 19.
[76] *See* Lucian A. Bebchuk and Mark J. Roe, *A Theory of Path Dependence in Corporate Governance and Ownership*, 52 STAN. L. REV. 127 (1999).

likely to be reinforced as complementary institutions develop[77]. With respect to corporate governance different systems may develop with the same functional effects. For example, depending on the environment, corporate performance can be monitored by an undiversified large shareholder or by lending financial institutions, or monitoring can be based on market-based mechanisms, such as takeovers or proxy fights[78]. Different legal solutions and corporate governance regulations would be relevant in these cases. In this context it is important to note that there is little evidence that a specific model of corporate ownership or corporate governance is superior. Each system of corporate governance has its strengths and weaknesses, but the weaknesses should be addressed in the context of the system.

There is some concern that the differences in economic systems that are deemed to prevail in the EU pose an extra challenge for introducing uniform EU regulation in the field of corporate law specifically. It is argued that national level regulation is often better adapted to the relevant institutional environment so that new regulation fits into the regulatory framework and that concepts are not introduced that are foreign to the reigning system of corporate governance[79]. It has been easier to introduce EU regulation in fields without strong national level institutions that would be challenged by the introduction of new regulatory models. It has been noted, for example, that EU regulation related to financial services has met less resistance, as many EU member states did not have developed market structures to defend[80]. However, distinct company law and corporate governance systems have generally developed at the national level in the EU member states over several decades, if not centuries. Efforts to introduce EU regulation will conflict with established structures reflecting the interests of dominant constituencies and the dynamic of the domestic systems[81].

The effects of EU level regulatory intervention may differ among the member states depending on the institutional environment, which does not facilitate the creation of a level playing field. Institutions can develop to complement existing features of the corporate environment. In this type of environment the introduction of supranational rules can have very different and unintended consequences[82]. For example, corporate governance mechanisms that are relevant in the context of dispersed ownership may not be meaningful or effective in a concentrated ownership environment, where the relevant regulatory concerns are completely different[83]. The effects of regulation can also depend on the availability of enforcement systems, such as court systems or agencies, where the quality of the relevant institutions across the EU can vary considerably[84]. It has been argued, for example, that the introduction of a mandatory break-through rule in the Takeover Directive would, in reality, likely not have facilitated challenging the control of large shareholders but lead to the further increase in the concentration of ownership and control as owners would have reacted to the new regulation[85].

This discussion emphasizes the importance of addressing corporate governance issues in the context of existing structures of ownership and control. It is important, regardless of the

[77] *See* DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE (1990).
[78] Marco Becht, Patrick Bolton & Ailsa Röell, *Corporate Governance and Control* 1 (ECGI Finance Working Paper 02/2002), *available at* http://ssrn.com/abstract=343461.
[79] Johnston (2009), *supra* note 9, at 181.
[80] Armour & Ringe (2011), *supra* note 1, at 27.
[81] *Id.*
[82] *See* Goergen (2007), *supra* note 32; *see also* Johnston, *supra* note 9, at 181.
[83] *Id.* at 16-17.
[84] *See* Young (2010), *supra* note 36.
[85] *See* Coates (2003), *supra* note 35.

source of regulation, be it national or supranational, that corporate governance regulation be adapted to the characteristics of the relevant institutional environment. This does not mean that EU level regulation would be inappropriate as such or that national level regulation is superior *per se*, but only that regulatory mechanisms should be better adapted to the prevailing institutional environment. Corporate governance mechanisms should be developed to address concerns related to the relevant environment, but regulation should not undermine the basic premises of the relevant governance system. This means that the standard and quality of corporate governance regulation has to be analysed and assessed in the context of the relevant institutional environment; i.e. how well does the regulatory framework address the vulnerabilities and potential for abuse in that particular system. EU level legal strategies should not disenfranchise specific forms of ownership or governance but, instead, seek to address the potential for abuse within existing governance structures. It is important to identify the relevant relationships that are vulnerable to abuse and then to apply appropriate legal strategies tailored to the institutional environment.

D. EVOLVING EU POLICIES REGARDING CORPORATE GOVERNANCE

The evolution of EU policies on corporate governance can be reviewed in light of the political dynamics referred to above. Below, I consider recent developments in EU corporate governance regulations in light of these dynamics.

EU policies regarding corporate matters and corporate governance have varied over the years. Until recently, it has been argued that the impact of EU regulation has, in fact, been limited with respect to corporate law[86]. Early integration of company law had slowed down at the end of the last millennium – in part due to remaining fundamental differences in corporate governance across the EU. However, EU regulation of company law has evolved significantly over the past decade. After the failure of more comprehensive initiatives, such as the Fifth Company law Directive Proposal, the EU Commission in 2003 issued a communication with the aim of modernizing company law[87]. In this action plan, the Commission adopted a more instrumental view on harmonization[88]. The introduction of EU level regulation would be based on an impact assessment and an analysis of the needs of businesses[89]. Harmonization efforts would not be introduced for the purposes of creating a level playing field alone. Regulatory intervention was also to be focused primarily on cross-border aspects of business where EU regulatory intervention could be better justified. Also, the regulatory mechanisms that would be used at the EU level should be "flexible in application, but firm in the principles"[90]. At the same time the EU also pursued a policy of simplifying the business environment for companies envisaging the development of a principles-based regulatory model corporate law in the EU[91].

---

[86] *See* Enriques (2006), *supra* note 4.
[87] *Communication from the Commission to the Council and the European Parliament - Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward*, COM2003(284) [hereinafter the Company Law Action Plan 2003].
[88] *See* Armour & Ringe (2011), *supra* note 1.
[89] *See* Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe, 4 November 2002, 4 *and* 29-31, *available at* http://www.ecgi.org/publications/documents/report_en.pdf [hereinafter High Level Group Report].
[90] Company Law Action Plan 2003, *supra* note 87, at 4.
[91] European Parliament Resolution of 21 May 2008 on a simplified business environment for companies in the area of company law, accounting and auditing (2007/2254(INI)), [2009] OJ C279E/36

More recently, several factors have affected the agendas outlined by the EU Commission[92]. The European Court of Justice has supported the freedom of establishment of corporations through a string of landmark decision from the *Centros*-case in 1999[93] to the *Vela* case decided in 2012[94]. With the evolving jurisprudence it has become more difficult for member states to restrict the movement of companies across EU borders. Recent EU regulatory initiatives have looked to further facilitate cross-border establishment.

The development of EU level capital markets regulation has also affected company law matters[95]. The EU has pursued a vigorous agenda of harmonization in the field of capital markets regulation. Importantly, some of the directives issued thereunder have considerable effects on corporate affairs – and on corporate law. The Transparency Directive, for example, established a framework for periodic and on-going disclosure requirements for listed companies, whereas the Takeover Directive regulates the corporate steps that can be taken by a target company in a takeover situation, and sets redemption obligations and redemption rights for shareholders in different situations (including regulation on mandatory offers and squeeze-out as well as on the use of shareholder rights in concert). More recently, the Commission has launched a program to establish a capital markets union to promote growth of European companies through better access to financial markets[96]. In this context the Commission has emphasised the link to corporate governance in inadequate corporate law and corporate governance rules, as well as the effects of non-harmonized and uncoordinated insolvency and tax laws[97]. The Commission also highlighted problems resulting from differences in regulatory enforcement[98]. This development may provide the basis for further EU action in the field of corporate law and corporate governance as well. The EU Commission has justified intervention in the field of corporate governance with the internationalization of equity capital markets and the increase in cross-border share ownership[99].

Finally, following the financial crisis, the Commission has pursued a more interventionist agenda with respect to corporate governance. The EU Commission first targeted financial institutions and introduced, among other, requirements on board structures in financial institutions[100]. The Commission then published a green paper on developing the EU corporate governance framework for listed companies in general[101]. Based on the feedback received on the Corporate Governance Green Paper the Commission launched a new action plan for

---

[92] Armour & Ringe (2011), *supra* note 1, at 2.

[93] Case C-212/97, Centros Ltd v Erhvervs- og Selskabsstyrelsen [1999] ECR I-1459.

[94] Case C-378/10 VALE Építési kft. [2012] ECR 00000.

[95] *See* Armour & Ringe (2011), *supra* note 1.

[96] *See Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Action Plan on Building a Capital Markets Union*, COM(2015) 468 final, 30.9.2015.

[97] *European Commission, Building a Capital Markets Union, Green Paper* COM(2015) 63 final, 18.2.2015, at 9 and 24-25.

[98] *Id*. at 24-25.

[99] *Id.*

[100] See http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm, and *Proposal for a Directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate, Brussels,* 20.7.2011, COM(2011) 453 final, 2011/0203 (COD).

[101] *See* the Corporate Governance Green Paper, *supra* note 1.

modernizing EU company law in late 2012[102]. Many of the more controversial initiatives in the Corporate Governance Green Paper have been deleted from the action plan. However, there has still been strong opposition to many of the proposals in the plan[103]. Pursuant to the Company Law Action Plan, the Commission has launched, and intends to launch, a number of specific regulatory initiatives[104]. One of the more important initiatives is the proposed amendment of the Shareholder Rights Directive[105]. The directive was intended to facilitate the use of shareholder rights throughout the EU setting minimum standards on access to information prior to general meetings, provisions on proxy voting and voting without physical participation. The directive also prohibited requirements for share blocking whereby a shareholder would not be able to trade shares during a period of time before the shareholders' meeting in order to use voting rights. Other initiatives taken so far include amendments to the Accounting Directives[106] and a Recommendation on corporate governance disclosures[107].

It has been argued that EU policy during the past decade has favoured shareholder-oriented models of corporate governance[108]. Despite the political rhetoric, this policy has not significantly changed in the aftermath of the financial crisis based on the regulatory instruments introduced as a part of the Company Law Action Plan. What has changed is that the EU has strengthened its position as a source for corporate regulation at the cost of the member states. There is less room for optionality in EU regulations, and more mandatory provisions superseding voluntary codes, for example.

This trend emphasizes the importance of developing the characteristics of EU corporate governance regulation. There has been concern that the legislative procedures at the EU level are not satisfactory and that, generally, regulatory initiatives have been watered down due to political compromises. It seems the EU political systems remain vulnerable to the political salience of corporate matters resulting at times in less optimal regulatory outcomes. Policies have also not necessarily been adapted to different institutional environments. This has resulted in new regulation having unwarranted effects. An important aspect to consider is the ability of the EU to introduce regulatory mechanisms that can be applied throughout the varied institutional landscape of the EU. Both regulatory concerns and the effects of

---

[102] *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Action Plan: European Company Law and Corporate Governance – a Modern Legal Framework for More Engaged Shareholders and Sustainable Companies*, COM(2012) 740/2 [hereinafter the Company Law Action Plan].

[103] *See* Swedish Corporate Governance Board, *Views on the EU Green Paper on the Corporate Governance Framework*, 19.7.2011, *available at* http://www.bolagsstyrning.se/media/53853/views%20on%20eu%20cg%20framework%20from%20the%20swedish%20cg%20board%202011-07-19.pdf.

[104] *See* the Company Law Action Plan, *supra* note 102, at 17-18.

[105] *Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement*, Brussels, 9.4.2014, COM(2014) 213 final, 2014/0121 (COD), hereinafter [SHRD II].

[106] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the Annual Financial Statements, Consolidated Financial Statements and Related Reports of Certain Types of Undertakings, Amending Directive 2006/43/EC of the European Parliament and of the Council and Repealing Council Directives 78/660/EEC and 83/349/EEC, OJ 29.6.2013, L182/19.

[107] Commission Recommendation of 9 April 2014 on the Quality of Corporate Governance Reporting ('Comply or Explain'), (2014/208/EU).

[108] *See* Laura Horn, *Corporate Governance in Crisis? The Politics of EU Corporate Governance Regulation*, 18 EUROPEAN L. J. 83 (2012).

regulatory mechanisms vary depending on the corporate and institutional environment, including the structure of corporate ownership and the availability and quality of legal institutions for enforcement.

III. The Political Dynamics of EU Corporate Governance Regulation

A central aspect in developing EU corporate governance regulation is related to the political dynamics of regulatory initiatives. Regulatory responses are the result of political processes and the efforts of affected constituencies pursuing their interest through the markets for regulation[109]. These dynamics affect the selection of areas to be regulated, the choice of regulatory goals, as well as the form and design of regulatory instruments. Regulatory outcomes will depend on the evolving preferences of interested constituencies, as well as on the structure of political institutions[110].

It is important to recognize the effects of supranational political systems, such as the EU, on the political dynamics of corporate governance regulation. The regulatory dynamic of the EU has been subject to much research[111]. The EU and its institutions form a political system akin other national or regional systems. The EU cannot merely be seen as an intergovernmental forum for the member states, of course, but rather as an independent political system facilitating the development of a multilevel governance system[112]. Moreover, EU integration as such, together with its institutional forms, reflects a polity in itself whereby certain political and economic agendas may be promoted[113]. In addition, the EU political institutions and the political processes for EU regulation pose their own challenges for pursuing regulatory change at the EU level[114]. The agendas and alliances of affected constituencies and interest groups may differ at the national and the EU levels[115] creating a challenging political dynamic to be taken into account when considering feasible strategies for regulatory intervention at the EU level. These characteristics of the EU must be understood when considering how EU regulation is formed.

This chapter will first discuss factors that affect the political and legislative dynamics at the EU level with regard to EU corporate governance regulation. The chapter will then provide a brief overview of recent EU policy and regulation related to corporate governance and how it can be seen to reflect the dynamics referred to above.

A. Implications of the "regulatory state"

Considering the constraints set on the EU institutions the considerable increase in both the amount and scope of regulatory initiatives originating from EU institutions has been found

[109] *See* Peltzman, *Towards a More General Theory of Regulation*, 19 J. of Law and Econ. 211 (1976), and George J. Stigler (1971), *supra note 15*.
[110] *See* Gourevitch & Shinn (2005), *supra* note 57.
[111] *See*, inter alia, Hix & Höyland, *supra* note 12, The Economics of Harmonizing European Law, *supra* note 7, The Transnational Politics of Corporate Governance Regulation (Henk Overbeek, Bastiaan van Apeldoorn & Andreas Nölke, eds., 2007), Regulating Europe (Giandomenico Majone, ed., 1996), Wayne Sandholtz & Alec Stone Sweet, European Integration and Supranational Governance (1998), and Policy-Making in the European Union, *supra* note 12.
[112] *See* Pollack (2010), *supra* note 12, at 36-37; *see also* Callaghan (2008), *supra* note 19.
[113] Pollack (2010), *supra* note 12, at 34-42; *see also* Laura Horn, Regulating Corporate Governance in the EU: Towards a Marketization of Corporate Control (2011) *and* McCann (2010), supra note 10.
[114] *See* Callaghan (2008), *supra* note 19.
[115] *See* Ferrarini & Miller (2009), *supra* note 8, at 15.

puzzling[116]. Member states could be expected to be on their guard in delegating authority or allowing supranational legal decisions bind domestic policies. An important factor to consider, however, is that the European Union has a variety of policy domains with different dynamics. In certain policy matters, such as defense and security, national governments may retain more sovereignity while the role of the EU institutions is broader in others, such as in the agricultural policies of the EU or, importantly, key areas of economic regulation.

The development of the EU has reflected the emergence of the "regulatory state". As the role of government has evolved over the 20th century, the importance of the government as a source of economic and social regulation has increased. Another mechanism for steering economic policy has been public ownership of assets. However, this avenue has much decreased in Europe in the decades following the Second World War. As the role of government has changed, it has been argued that the EU, as a political system, is increasingly alike any other government systems. However, with limited taxation and budgetary powers, the role of regulation is emphasized as a means to pursue policy. This is supported by the hierarchical legal system adopted in the EU.

The EU has provided an opportune forum for regulatory policy-making in the EU region for responding to emerging changes in the international economy[117] with an increased need for coordinating standards among private actors on a cross-border basis. The EU model was successful in combining transnational standards with national differences[118]. The institutional structure, with negotiation processes supported by the EU legal system, but with less immediate parliamentary pressures, has also been deemed an important factor in this regard. Thus both national policy-makers and industrial interest groups have found the EU as an opportune avenue to pursue policy and change in the industrial and economic systems of EU member states.

The characteristics discussed above have political implications. Political analysts have suggested that EU corporate governance initiatives have promoted market liberal policies over the past decade. In particular, the EU single market program has contributed to this development[119]. There has been much debate on the dynamics of the single market program – and whether supranational actors or bargaining member states had the decisive role in launching the program[120]. Transnational business interests have been argued to have a central role, directly and/or indirectly, in this regard, while the EU Commission has been seen as the central policy entrepreneur, setting the agendas towards market integration[121].

The institutional structure of the political decision-making processes will also affect the dynamic of policy-making and regulatory outcomes. Certain institutional characteristics of the EU "regulatory mode" have been identified, including the following:

- "The central role of the Commission in defining and pursuing regulatory objectives (often economically motivated);

[116] Giandomenico Majone, *The Rise of Statutory Regulation in Europe, in* REGULATING EUROPE, *supra* note 111, at 56-57 and 61.
[117] Wallace (2010), *supra* note 21.
[118] *Id.*
[119] Wallace & Wallace (2007), *supra* note 20, at 345, and Alasdair R. Young, *The Politics of Regulation and the Internal Market* 373, 376-377 in HANDBOOK OF EUROPEAN UNION POLITICS, *supra* note 20.
[120] Young (2007), *supra* note 119, at 374.
[121] *Id.* at 374-375.

- Cooperation between the Commission and stakeholders and experts;

- The Council as a forum for agreeing minimum standards and the level of harmonization;

- The role of the EU legal system as a means to ensure even implementation, and to provide redress to private actors;

- The role of the European Parliament in introducing non-economic factors to the regulatory initiatives;

- The central role of regulatory agencies; and

- Extensive opportunities for interest groups to influence EU level regulation" [122].

The effects of these factors must be assessed in order to better understand the dynamic of the EU corporate governance regulation. The EU Commission has a central role in defining the regulatory agenda – also with respect to initiatives in the field of corporate governance. The institutional structure of the EU allows stakeholders (both political and economic stakeholders) to seek to influence these agendas. Competitiveness of the EU region and facilitating the development of the single market have been used as arguments underlying new corporate governance initiatives[123]. This may reflect the influence of investors over those of corporate insiders, who may have more influence at the national level and benefit from less intrusive EU level regulation. The increasing role of the EU with respect to corporate law in general has also been driven by the role of the EU legal system and landmark rulings of the European Court of Justice (the "ECJ") from the *Centros*-case in 1999[124] to the more recent *Vale* case decided in 2012[125].

B. INTEREST GROUPS AND REGIONAL VARIETIES

With respect to corporate governance, the EU has resulted in a multilevel governance framework[126] where different interest groups can seek to coordinate political action both at national and EU levels. The institutional structure of the EU will also affect which policies can best be pursued at the EU level and which are the parties that are able to best coordinate at different levels of governance[127]. In this respect it is important to note that similar interest groups in the different member states may or may not favor the same policies at the EU level. Indeed, there have been clear regional differences in the EU with respect to preferred policies in corporate governance. The Takeover Directive has often been referred to as an example of regulatory initiatives where these differences was most pronounced and reflected different systems of corporate governance[128].

[122] Wallace (2010), *supra* note 21, at 95-96.
[123] *See* the Company Law Action Plan, *supra* note 102.
[124] Case C-212/97, Centros Ltd v Erhvervs- og Selskabsstyrelsen [1999] ECR I-1459.
[125] Case C-378/10 VALE Építési kft. [2012] ECR 00000.
[126] *See* Hooghe & Marks (2000), *supra* note 18; Callaghan (2008), *supra* note 19; Pollack (2010), *supra* note 112.
[127] Young (2007), *supra* note 119, at 383.
[128] *Supra* note 30.

Interest Groups

The shareholders, management and employees of a corporation are often identified as the key constituencies in corporate governance[129]. Other relevant interest groups include lenders and other providers of external financing, as well as politicians in times when the political salience of corporate governance has been pronounced[130].

Different corporate constituencies will seek to promote their interests through corporate governance regulation, among other. Corporate constituencies are also interest groups that can use political means to further their own interests. Regulation can be seen as the outcome of the interaction between political and market structures, reflecting the impact of interested market participants and the political environment[131]. In this respect corporate law and corporate governance regulation can be expected to reflect the institutional power of dominant corporate constituencies[132]. For example, in markets with a prevalence of concentrated ownership, corporate governance regulation can be expected to favour blockholders. In markets with dispersed ownership, where shareholders face coordination problems, corporate governance can be expected to favour management. In this regard labor is also a significant corporate constituency often with considerable political clout. In basic agency analysis labor is sometimes excluded as an external constituency as the contracts between the company and labor are assumed to be complete[133]. However, these contracts are often renegotiated depending on the relative bargaining power of unions. If the role of labor increases significantly in the production chain, for example, this can be expected to affect corporate governance solutions. In the EU it has been argued that the strong position of labor has had a significant with Germany as an example[134]. Creditors are another external constituency that also has significant interests in corporate governance that can be pursued through policy and regulation. In particular, in economies with a financial system dominated by financial intermediaries, such as banks, the role of external creditors in corporate governance has been significant.

Typically, corporate governance and corporate governance regulation have been studied in the context of the interaction of the interest groups described above. However, corporate governance can also have external political elements as legislators respond to political pressures more or less related to corporate matters – as has been the case in the aftermath of the financial crisis. For example, the EU legislative process is subject to political concerns and the need to address politically salient issues can be seen in EU initiatives – regardless of their relevance to the governance of business enterprise. As long as corporate governance regulation remains a "low salience"[135] matter the political dynamic, and the related "market for regulation", is mainly dominated by the traditional interest groups, i.e. investors, management and employee groups. However, to the extent that corporate governance related

---

[129] John Armour, Henry Hansmann & Reinier Kraakman, *Agency Problems and Legal Strategies* 35, 35-37, in THE ANATOMY OF CORPORATE LAW, *supra* note 37.
[130] *See* PEPPER D. CULPEPPER, QUIET POLITICS AND BUSINESS POWER, 2011.
[131] *See* Stigler (1971), *supra* note 15, Peltzman (1976), *supra* note 109, Roe (2000), *supra* note 72, MARK ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE (2003).
[132] Armour, Hansmann & Kraakman (2009), *supra* note 37, at 32.
[133] Gourevitch & Shinn (2005), *supra* note 57, at 8.
[134] *Id.*
[135] *See* Culpepper, *supra* note 130.

issues do become matters of "high salience"[136] that dynamic can change significantly. Significant reforms of securities and corporate law are often launched in the aftermath of market crisis[137] and such initiatives may be affected by the sense of urgency and public outcry related to the crisis[138]. There has been an increased pressure for political reactions to the financial crisis which has been channelled to corporate governance regulation due to the high political salience of corporate matters in the aftermath of the financial crisis as well as to the fact that listed companies have been subject to "regulatory capture" – i.e. they have already been subject to a regulatory framework that regulators have been able to use. Corporate governance regulation has been an avenue for demonstrating political action for the electorate.

Regional Variety

Industrial and economic structures in the EU vary. With respect to the corporate environment there are considerable differences among the EU member states. In the EU, the debate on corporate governance has been related to the "varieties of capitalism" debate in political science seeking to understand institutional differences and similarities among economies[139]. With regard to corporate governance the "varieties of capitalism" approach looks at how the structure of national economies is reflected in the structure of corporate ownership and in how coordination problems are resolved in different economic systems, and what the roles of different institutions and organizations are in this respect[140]. Corporate governance systems generally reflect the overall structure of the economy and provide different regulatory solutions. Scholars have categorized economies into liberal market economies and coordinated market economies based on the systems of coordination used to organize business activities and relationships with third parties. Firms in market liberal economies refer to market-based arrangements, whereas relational contracting and collaborative relationships are more important for firms in coordinated market economies.[141] Market oriented models are generally deemed to emphasize shareholder primacy, but are also associated with models of dispersed corporate ownership and strong management control dominant in the United States and, to some extent, the United Kingdom (also referred to as "Anglo-Saxon" governance models). Coordinated market models have been deemed to dominate much of the continental EU and are based on stakeholder oriented models of governance characterized by labour involvement in governance and by block-holder control. An important aspect of the "varieties of capitalism" –approach is that the structure of the economic system is supported by the development of complementary institutions, such as sources of financing or governance structure, adapted to the requirements of the specific economy. This will promote the performance of the firms within the economy but also lead to the specialization of economies on specific types of production.

---

[136] *Id.*
[137] *See* Klaus J. Hopt, *Comparative Corporate Governance: The State of the Art and International Regulation*, 16-17 (ECGI Working Paper No. 170, 2011), *available at* http://ssrn.com/abstract_id=1713750, Armour & Ringe (2011), *supra* note 1, at 6, AFTER ENRON: IMPROVING CORPORATE LAW AND MODERNIZING SECURITIES MARKETS (John Armour & J.A. McCahery, eds., 2006).
[138] Hopt (2011), *supra* note 137, at 17.
[139] Peter A. Hall & David Soskice, *An Introduction to Varieties of Capitalism*, in VARIETIES OF CAPITALISM, THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE 1, 2-3, (Peter A. Hall & David Soskice, eds., 2001).
[140] *Id.* at 6-7.
[141] *Id.* at 8-9.

The "varieties of capitalism" debate can possibly be defined in terms of path dependence where a given "variety" reflects a particular point in the specific development path of an economy. Nevertheless, the approach highlights the fact that different corporate governance environments raise different governance issues that require different solutions. This, of course, creates considerable challenges for EU wide regulation. In an EU context it is also possible that benefits of regulation are not evenly distributed. Market actors in jurisdictions with a favourable institutional environment may have an advantage over actors in other jurisdictions. When markets are being opened through EU regulation, some will be better positioned than others to take advantage of the new situation. In fact, connection with corporate governance regulation, there have been regionally based cleavages between the northern and southern regions of the EU as well as between the northern and eastern regions. The Takeover Directive, though dated, has often been referred to in this regard, as will be discussed briefly below.

Varying Interest Group Influence

Some scholars believe that with the development of EU level regulation traditional industry groups will be able to coordinate their actions on an international level and focus their efforts to lobby favourable EU level regulation[142]. However, others argue that the EU framework creates a multilevel framework of regulation that affects how interested constituencies can pursue their interests through the political systems[143].

The preference for regulatory competition (national regulation) or harmonization (EU regulation) may be driven by how the relevant constituency can best promote its interest – in relative terms. Constituencies with considerable sunk costs and a high threshold for corporate mobility may not be able to take advantage of the freedom of establishment. To prevent competitors from taking advantage of more competitive regimes they would opt for EU level harmonization setting similar rules throughout the EU that would cater to existing industrial structures. Constituencies with lower costs for relocating, on the other hand, will lobby for national regulation and regulatory competition, as they can move their operations to jurisdictions with more favourable regulation, for example[144]. It has been argued that large transnational business interests prefer harmonized regulation as they can operate with the same standards throughout the EU – and may have the ability to coordinate political action efficiently at the EU level[145].

It is also possible that key industry groups with considerable political leverage at the national level are not be able to affect EU level corporate regulation in the same way. For example, Ferrarini & Miller argue that at the national level takeover regulation may be more likely to favour target companies and their management, while the relative position of institutional investors may be better at the EU level, for example[146]. At the domestic level, interest groups representing management, labour and community groups are likely to advocate for rules that increase the threshold for takeovers[147]. At the international (or federal) level, however, the

[142] Hix & Hoyland (2010), *supra* note 12, at 211.
[143] *See* Hooghe & Marks (2000), *supra* note 18.
[144] *See* Pelkmans & Sun, *supra* note 29.
[145] Young (2007), *supra* note 119, at 374-375.
[146] Ferrarini & Miller (2009), *supra* note 8, at 15.
[147] *See* Roberta Romano, *The Political Economy of Takeover Statutes*, 112 VIRGINIA L.R. 111 (1987).

influence of these interest groups may be more balanced[148]. Corporate insiders may not have the same relative advantage over the interests of bidders (and minority shareholders) who may better be able to organize themselves on an international basis.

The concerns identified above have some support in findings from the United States. In analyzing the development of state corporate regulation, Bebchuk & Hamdani find that states have generally favored corporate insiders whereas federal regulation has more consistently favored external investors and minority shareholders[149]. The authors argue, in line with Ferrarini & Miller, that corporate insiders do not have the same political influence at the federal level and that other constituencies are better able to cooperate at this level of regulation – possible due to economies of scale. In a long-term empirical analysis, Cheffins, Bank & Wells support this view and argue that U.S. federal regulation has played a crucial role in enhancing shareholder rights[150].

It has been argued that altogether it may be more difficult for individual interest group to promote their interests at the EU. The EU provides an alternative and parallel framework for pursuing interests through the political system resulting in a system of multilevel governance that may be less prone to be dominated by specific policies. The EU institutional set-up allows for competing political coalitions to simultaneously advance different reforms thus limiting the possibility for interest groups to monopolize policy[151]. Callaghan, for example, argues that the multilevel system established with the introduction of the EU framework increases strategic opportunities for using regulation to pursue policies across the EU – regardless of the national system of corporate governance[152]. Also, the institutional set-up of the EU allows different types of policies to be pursued simultaneously. In other words, it is not as easy for a single interest group (or coalition) to dominate the political agendas regarding a particular field of regulation. This can result in reforms reflecting, at the same time, different policies.

C. THE INSTITUTIONAL STRUCTURE AND THE LEGISLATIVE PROCESS

The institutional structure of the EU will also have a significant effect on policy and regulation. The structure of political institutions affects how regulatory agendas are set and how general political and specific interest group agendas affect the regulatory processes. Understanding the roles and interactions of the EU legislative institutions is important in this regard.

The Commission

The EU Commission has a central position as an initiator of regulatory initiatives. The Commission can use different political tools to pursue its goals, including agenda setting powers and packaging of regulatory proposals to maximize the likelihood of their acceptance,

---

148 *See* Ferrarini & Miller (2009), *supra* note 8.
149 *See* Lucian A. Bebchuk & Assaf Hamdani, *Federal Corporate Law: Lessons from History* (HLS John M. Olin Center Discussion Paper Series, 2006), *available at* http://lsr.nellco.org/harvaard_olin.
150 *See* Brian R. Cheffins, Steven A. Bank & Harwell Wells, *The Race to the Bottom Recalculated: Scoring Corporate Law Over Time* (ECGI Law Working Paper 261, 2014), *available at* http://ssrn.com/abstract_id=2475242.
151 *See* Callaghan, *supra* note 19.
152 *Id.*

or mobilizing interest groups to set political pressure on national governments or the European Parliament[153]. The key question that arises is how the regulatory policies of the Commission are formed. The EU polity and the interaction among member states and relevant supranational actors in defining EU policies are of course important in this regard. As discussed above, the policies of the past decades have favored a liberalist agenda in economic policy – also with respect to corporate regulation.

It is important to recognize that regulatory policies include discretion by regulatory agencies. Agency theory is often applied in political relationships, where regulatory agencies are established to serve the interests of their appointees, but where those agencies will have sometimes considerable discretion over how they use their authority. This model is also used to describe the position of the European Commission. The Commission is not a perfect "agent" of member states, of course, but has independent interests and can use its powers selectively[154]. While the Commissioners are appointed by national governments, the Commission ultimately has considerable discretion in setting agendas and pursuing policies not always favored by their "principals". Moreover, as the Commission has several national principals with diverging interests, this discretion is further increased. In terms of regulation theory the Commission has been seen as a "policy entrepreneur"[155]. The Commission can select policies, set agendas and restrict choices available to other political actors, and involve other constituencies in the political processes to increase pressure or to build coalitions for pursuing its policies of choice[156]. The Commission can identify potential political alliances when promoting new regulatory initiatives to ensure that the initiative is acceptable to key political and industry actors and that the structure and design of these initiatives takes the key concerns of these constituencies into consideration. It is possible that the interests of industry representatives and governments vary among jurisdictions depending on the applicable economic structures, and that different alliances would be formed from time to time with regard to political and lobbying efforts.

The view of the Commission as a coherent single actor has also been challenged, and the internal dynamics of the Commission have been studied based on the agendas of individual commissioners, who can be seen to represent interests of their national parties, transnational parties at the EU level, their respective governments or their respective fields of responsibility in the Commission (directorate general)[157]. The incentives and the dynamics of the Commission may vary depending on the matter at hand, but in specific controversial cases individual Commissioners have been argued to have acted as national agents or as representatives of their respective fields of responsibility[158].

The Legislative Dynamics

While the initiative for introducing new regulation generally lies with the EU Commission, the legislative process of the EU has evolved over the years, and now includes the EU Council of Ministers as well as the EU Parliament in increasing roles.

---

153 Hix & Hoyland (2010), *supra* note 12, at 25 and 47-48.
154 *Id.* at 212.
155 *See* JOHN W. KINGDON, AGENDAS, ALTERNATIVES AND PUBLIC CHOICES (1984).
156 Hix & Hoyland (2010), *supra* note 12, at 212.
157 Arndt Wonka, *Decision-Making Dynamics in the European Commission: Partisan, National or Sectoral?* 15 J. OF EUR. PUB. POL. 1145, 1148-1151 (2008).
158 *Id.; see also* Robert Thomson, *National Actors in International Organizations: The Case of the European Commission*, 41 COMP. POL. STUDIES 169, 187-188 (2007).

The workings of the Council of Ministers have been fairly opaque, but research has nevertheless focused on the deliberative nature of the process regarding new legislative proposals. Empirical research suggests that there are often considerable efforts to reach consensus in the Council, but that when voting occurs, a tendency of regional blocks has been observed, where policies favored by countries in Northern Europe can be seen to differ from those in the South and the Eastern parts of the EU[159]. This regional dynamic varies but has been seen in situations where EU regulation would have a significant impact on regionally established structures.

Interestingly, the voting patterns of the EU parliament often follow the international party affiliations of the parliamentarians rather than national or regional blocks[160]. One explanation provided for this group loyalty has been that parliamentarians divide tasks to cope with the extensive legislative agendas, and rely on party associates to pursue similar policies across these agendas. They also have little to gain from deviating from set policies of their parties as matters at the EU level rarely have immediate high salience with national electorates[161]. Hence voting patterns that do deviate from this pattern may be of some interest. For example, where voting patterns would deviate so that they would be aligned with national or regional blocks it could be argued that the legislative proposal might have collided with national or regional interests of particular political significance. The voting patterns of the EU parliament have been studied in connection with the introduction of the Takeover Directive, for example[162].

The Takeover Directive

The legislative history of the Takeover Directive has often been used as an example of the complexity of introducing EU regulation, and, though preceding the Lisbon Treaty and thus representative of an earlier legislative process, serves the purposes of this study as well. The directive has a long and infamous history extending over 20 years from first being introduced by the Commission on more than one occasion until being finally approved in 2003, with an earlier version of the directive having failed to be adopted in 2001 by the closest margin possible[163].

The Takeover Directive has been seen as an effort to introduce mechanisms that facilitate the development of an active market for corporate control[164]. This has been interpreted as a polity in itself – as a marketization of corporate control that, in the "varieties of capitalism" literature, was not adapted to corporate governance systems prevalent in the EU. The takeover mechanism as such was seen to provide a means to circumvent decision making power related to change of control in EU listed companies benefitting shareholders at the cost of employees

---

159 *See* Běla Plechanovová, *The EU Council Enlarged: North-South-East or Core-Periphery?* 12 EUROPEAN UNION POL. 87 (2010).
160 *See* Simon Hix, Abdul Noury & Gérard Roland, *Voting patterns and alliance formation in the European Parliament*, 362 PHIL. TRANS. R. SOC. B, 821 (2009).
161 *Id.* at 829.
162 *See* Callaghan & Höpner (2005), *supra* note 30, Bastiaan van Apeldoorn & Laura Horn, *The Transformation of Corporate Governance Regulation in the EU – From Harmonization to Marketization*, *in* THE TRANSNATIONAL POLITICS OF CORPORATE GOVERNANCE REGULATION, *supra* note 111, at 77, 90-95, and Wonka (2008), *supra* note 157, at 1155-1158.
163 *See* Rolf Skog, *The Takeover Directive – an Endless Saga?*, 13 EUR. BUS. L. REV. 301 (2002); *see also supra* note 162.
164 Callaghan & Höpner (2005), *supra* note 30, at 312.

and management[165], and that this ran against the whole system of corporate governance established in many EU jurisdictions. For example, a change of control could lead to a breach of implicit agreements among corporate constituencies and the emphasis of share price and dividends over the provision of stable jobs and wages. It has been pointed out, however, that the mere change of control should not trigger a need to terminate implicit agreements if those have formed the basis of an effective corporate governance arrangement[166].

The differences in how the Takeover Directive would affect member states were of significance for the political dynamics of the legislative process. A uniform takeover framework has different implications nationally depending on the system of corporate governance[167]. Firms in jurisdictions lacking active markets for corporate control may become targets more easily than in countries where such markets have been the norm[168]. Different national starting points may thus result in the benefits of a uniform framework being initially distributed unevenly. But such immediate consequences may not be so unusual in the context of supranational harmonization, where regulation in some countries may be required to be changed more than in others. Importantly, however, a uniform takeover framework may also include elements that challenge complementary institutions in a specific system of corporate governance. This may increase the salience of the legislative proposal and result in strong national and regional political pressure. Individual provisions of the draft directive included elements that were argued to directly challenge the basis of these corporate governance systems. The break-through rule limiting the effects of control enhancing mechanisms in takeover situations was deemed to challenge the decision rights of controlling shareholders, while the neutrality rule prevented management from independently adopting measures that may hinder the completion of a takeover bid.

The Commission pursued the introduction of EU level takeover regulation on several occasions since the 1970's, but a draft proposal was issued by the Council only in 2000. It can be noted that the final negotiations in the Council were stalled by Spain for reasons seen to be related to the status of Gibraltar rather than to the directive[169]. The European parliament proposed a number of amendments to the proposal resulting in a conciliation process. A key issue was the neutrality requirement opposed by, among other, the German MEP acting as rapporteur on the directive. It has been presented that the German car industry heavily lobbied the Council and the Parliament to prevent the board neutrality requirement in the proposed directive[170]. As a result, Germany announced it would withdraw its support for the Council proposal, but opening the negotiated proposal raised considerable opposition from other member states and the draft directive was left unchanged in this regard. Lobbying remained heated in the parliamentary phase creating regional cleavages among the largest political groups in the EU parliament[171]. The large center-left and center-right groups split along regionally or nationally aligned groups with, for example, most German MEP's voting against

[165] *Id.* at 312-313.
[166] *See* Gilson (1992), *supra* note 67, at 189-191.
[167] Callaghan & Höpner (2005), *supra* note 30, at 313-314.
[168] *Id.* at 314.
[169] *Id.* at 310.
[170] *See* Klaus Hopt, *Takeover Regulation in Europe – The Battle for the 13th Directive on Takeovers*, 15 AUSTR. J. OF CORP. L. 1 (2002) and Skog (2002), *supra* note 163.
[171] Callaghan & Höpner (2005), *supra* note 30, at 307.

the proposal, while most of the UK MEP's supported the proposal[172]. The smaller political groups with leftist agendas, as well as those on the right, did vote along party lines[173].

Interestingly, in working towards the final version of the directive, there were further efforts to introduce certain controversial mechanisms. A break-through rule had been introduced to limit the effects of different control enhancing mechanisms in connection with takeovers. In order to isolate Scandinavian countries that were opposed to the directive, it was proposed that the rule should cover the effects of different share classes (often used in Scandinavia) but not the use of double voting rights applied in French companies[174]. At the end of the day the break-through rule was introduced, but subject to a national opt-in used by very few member states.

The fact that the vote in the EU parliament followed national and regional blocks certainly reflected the fact that the proposal challenged considerable national or regional political interests. This time the regulatory proposal had challenged fundamental structures of national and regional economies that raised the concerns of EU parliamentarians.

Proposal to Amend the Shareholder Rights Directive

The Commission proposal to amend the Shareholder Rights Directive is a more recent controversial corporate governance initiative. The proposal was launched in 2014 pursuant to the Company Law Action Plan, and included several significant elements, including transparency and decision-making regarding director remuneration, decision-making regarding related party transactions and facilitating the exercise of shareholder rights[175].

One of the more controversial proposals addresses related party transactions. The Commission proposed that shareholders must be granted to right to vote on significant related party transactions and that where the transaction involves shareholders, such shareholder does not have the right to participate in the vote. The policy goals of the proposal are related to the protection of minority shareholders against abuse by directors or controlling shareholders. However, the proposal provides minority shareholders a veto right that challenges and may undermine control rights of controlling shareholders.

The proposal has been subject to much debate and has been heavily negotiated in the Council. During the Council process the provision has been amended significantly. First, the revised Council proposal allows for related party transactions to be approved by other corporate bodies than shareholders' meetings – provided that procedures are followed "which prevent a related party from taking advantage of its position and provide adequate protection for the interests of …. minority shareholders"[176]. Moreover, the Council proposed that the approval procedure does not need to apply, subject to the discretion of member states, to transactions entered into in the ordinary course of business and concluded on normal market terms[177]. In these cases, the "administrative or supervisory body of the company shall establish an internal

[172] *Id.* at 325.
[173] *Id.* at 324.
[174] Ulf Bernitz, *Mechanisms of Ownership Control and the Issue of Disproportionate Distribution of Power*, *in* COMPANY LAW AND ECONOMIC PROTECTIONISM – NEW CHALLENGES TO EUROPEAN INTEGRATION 191, 194-195 (Ulf Bernitz & Wolf-Georg Ringe, eds., 2010).
[175] SHRD II, *supra* note 105, at 8-9.
[176] Council of the European Union, Interinstitutional File 2014/0121(COD), 20 March 2015, 7315/15, Art 9c, at 46-47.
[177] *Id.* at 46.

procedure to periodically assess whether these conditions are met", while the related parties shall be excluded from participating in such assessment. Finally, the proposal provided that member states may allow a related party shareholder to participate in a relevant vote "provided that national law ensures appropriate safeguards which apply before or during the voting process to protect the interests of … minority shareholders, by preventing the related-party from approving the transaction despite the opposing opinion of the majority of shareholders who are not related parties or despite the opposing opinion of the majority of independent directors"[178].

The amended proposal can be seen to represent concerns related to governance systems based on concentrated ownership and may reflect regional cleavages in the Council. While related party transactions and private benefits of control have been problematic in some parts of the EU, others report very low levels of private benefits despite concentrated ownership (the Nordic region, for example)[179]. In connection with the proposal, the German legislation on groups of companies has been seen as a regional approach to related issues, where Germany may well prefer its own existing solutions[180]. The Council proposal recognizes that related party transactions may be appropriate and that granting minority shareholders veto rights can challenge control rights of controlling shareholders in an opportunistic manner. However, the proposal remains fragmented and seems to reflect political negotiations and the lack of sufficient institutional analysis of corporate governance mechanisms in different types of corporate environments. The proposal could have included more thorough and detailed regulation of transparency of related party transactions and of legal standards applied to such transactions.

The proposal has also been subject to debate at the level of the European Parliament. A revised proposal was submitted by the Parliament rapporteur in May 2015, including amendments to the proposed rules of related party transactions[181]. The Parliament proposed somewhat stricter requirements on related party transactions but maintained the dynamic adopted by the Council that makes the provision better adapted to different types of corporate environments. For example, Parliament did not require general meetings to approve all related party transactions with shareholders, and allowed different mechanisms to be used to assess the fairness of the dealings. In many respects, the proposals of the Parliament incorporated external corporate governance elements in increased transparency requirements and in targeting politically salient concerns. In fact, the parliamentary revisions could even be argued to represent efforts by parliamentarians to react to the high salience of corporate governance to appease the electorate rather than the result of an institutional analysis of the effects of the adopted regulatory position.

The dynamics related to SHRD II highlight the effects of regional cleavages in EU level corporate governance regulation. The proposal will likely be further amended during the legislative process, but it seems that the regional interests are likely to be reflected in the

[178] *Id.*
[179] *See* Tatiana Nenova, *The Value of Corporate Voting Rights and Control: A Cross-country Analysis*, 69 J. FIN. ECON. 325 (2003).
[180] *See* Hopt (2015), *supra* note 1.
[181] *See European Parliament, Report on the Proposal for a Directive of the European Parliament and of the Council Amending Directive 2007/36/EC as regards the Encouragement of Long-term Shareholder Engagement and Directive 2013/34/EU as regards Certain Elements of the Corporate Governance Statement,* May 12, 2015, A-8-0158/2015, *and European Parliament, Long-term Shareholder Engagement and Corporate Governance Statement,* July 8, 2015, P8_TA-PROV(2015)0257.

amendments. The Commission can already be criticized, however, for neglecting a sufficiently robust institutional analysis of the policy area to be regulated, or indeed of the expected political dynamic triggered by the initial proposal. Clearly, more work could have been done to formulate a proposal better adapted to the varied EU corporate environment.

D. The Regulatory Politics of EU Corporate Governance Regulation

Understanding the politics of EU corporate governance regulation is important for a better understanding of the regulatory outcomes, and how these outcomes are likely to develop in the future. It should also be a part of the legislative process to identify the anticipated political dynamic related to regulatory initiatives. It would be important for the EU Commission, for example, to be able to identify potential political allies when promoting regulatory programs. The drivers of key constituencies affected by the regulatory initiative should be understood and, where possible, taken into account in designing regulatory mechanisms.

The dynamics of policy making depends on the type of matter at hand and the perceived distribution of costs and benefits from the initiative, for example[182]. If costs are dispersed and benefits concentrated, small interest groups are incentivised to lobby for favourable outcomes; if costs are concentrated but interests diffuse, the policy entrepreneur will likely need to mobilize political support in order to pursue the policy successfully[183]. On the other hand, if costs and benefits are both dispersed, interest groups are unlikely to form and policy will be driven by majoritarian politics; and if costs and benefits are both concentrated, policy will be affected by interest-group politics[184]. It has been argued that on balance entrepreneurial policy making is more pronounced at the EU level due to the smaller role of redistributive policies, among other[185]. Interest groups dynamics may also otherwise differ at the supranational level.

The regulatory politics vary with respect to corporate governance regulation. However, on a general level, the supranational level of intervention provides economies of scale for diverse interests to coordinate political action and has been seen to provide outcomes that represent such interests[186] (or that at least are more balanced than national level outcomes[187]). However, when promoting such interests it is important to seek outcomes that do not unnecessarily burden or challenge the position of other interest groups. More importantly, the outcomes should not undermine governance systems. With respect to corporate governance regulation, this emphasizes the need to adapt regulatory mechanisms to their institutional environments.

The institutional structures of the EU have a significant impact on the regulatory processes. Understanding the institutional dynamics of the EU is also important so that initiatives can be successfully introduced through the legislative process. In this regard the dynamics of the EU Council and the Parliament are increasingly important – as was experienced in connection with the introduction of the Takeover Directive, for example. With regard to corporate governance regulation it remains important to understand potential regional varieties in governance systems and how this is represented in the effects of regulation.

---

[182] See JAMES Q. WILSON, THE POLITICS OF REGULATION (1980) and Giandomenico Majone, *The European Commission as Regulator* 76-77 *in* REGULATING EUROPE, *supra* note 111.
[183] Majone (1996), *supra* note 111, at 77.
[184] *Id.* at 76
[185] *Id.* at 77-78.
[186] Young (2007), *supra* note 119, at 383.
[187] Ferrarini & Miller (2009), *supra* note 8, at 43.

IV. Legal Strategies and Regulatory Design in the EU

This chapter has discussed the dynamics of EU corporate governance regulation – including the interaction between national and supranational levels of regulation, the influence of interest groups and the effects of the institutional structures of the EU on regulatory processes and outcomes. The study now turns to considering the implications of these factors for developing EU corporate governance regulation and related legal strategies. This chapter considers the regulatory implications of the dynamic described above.

As discussed, the key problems identified at the EU level relate to the effects of EU regulation which have been deemed to vary depending on the relevant corporate environment, including the structure of corporate ownership, the characteristics of legal institutions and the prevalent financial systems, for example[188]. Another problem has been that EU regulation has often argued to be the result of unsatisfactory legislative processes and significant compromises resulting in watered-down regulation[189]. Finally, there is only a limited array of regulatory instruments available at the EU level and both interpretation and enforcement relies often on member states resulting in varied application through the EU[190].

This chapter discusses legal strategies for corporate governance regulation and the preconditions for developing regulation at the EU level.

A. Legal Strategies for Corporate Governance at the EU Level

Different legal strategies can be used to address corporate governance concerns – ranging from standards for decision making in the corporation (fiduciary duties or equality of shareholders) to mechanisms allowing shareholders to veto corporate decisions or to change management, for example. For the purposes of this study it is interesting to consider what implications the dynamics of EU corporate governance regulation has on the choice of legal strategies at the EU level. Additional challenges result from the nature of EU regulation – often requiring national implementation and enforcement measures.

Armour, Hansmann & Kraakman have introduced a typology of legal strategies for dealing with agency problems in the context of corporate governance regulation[191]. While this approach may remain rooted in agency theory it provides an important benchmark for assessing the scope of mechanisms and instruments available for regulators, as well as the effectiveness or relevance of these in different environments. This study briefly outlines the typology and then proposes further considerations and amendments to the typology based on a political approach to corporate governance regulation.

The authors separate ex ante and ex post mechanisms, as well as regulatory strategies and governance strategies. They then discuss the institutional environments in which these different strategies and mechanisms can be meaningfully introduced. The authors identify four subsets of regulatory strategies and six subsets of governance strategies, and divide those into ex ante and ex post categories as per the table below.

---

188 Johnston (2009), *supra* note 9, at 181.
189 *See* Enriques (2005), *supra* note 4.
190 Enrigues (2006), *supra* note 47, at 12.
191 Armour, Hansmann & Kraakman (2009), *supra* note 129, at 39.

Strategies for Protecting Principals[192]

	Regulatory Strategies		Governance Strategies		
	Agent Constraints	Affiliation terms	Appointment Rights	Decision Rights	Agent Incentives
Ex Ante	Rules	Entry	Selection	Initiation	Trusteeship
Ex Post	Standards	Exit	Removal	Veto	Reward

Regulatory strategies that may be used to constrain the activities of the agent include rules (ex ante) and standards (ex post). Many corporate governance matters may require more complex assessments that cannot readily be regulated through specific rules but lend themselves better to ex post assessments of propriety (standards such as the fiduciary duties of management, for example). Further regulatory strategies identified by Kraakman et. al. include the terms of entry and exit for principals[193]. Terms of entry include disclosure obligations for agents (managers) providing information for outside investors prior to becoming shareholders. Exit terms would include appraisal rights and transferability of shares, for example.

Governance strategies include appointment rights, i.e. the right to select and remove agents. Selection rights apply both to the agency relationship between shareholders and managers and the relationship between majority and minority shareholders (i.e. allowing board selection rights to minority holders as well).[194] Other governance rights include decision rights and agent incentives. Decision rights can take the form of the right to initiate or ratify management decisions, i.e. which corporate decisions are subject to shareholder approval. Significant differences can be identified in this regard between jurisdictions with a tradition of predominantly concentrated ownership and others with dispersed ownership, for example[195]. Agent incentives are generally based on mechanisms whereby agents are rewarded based on their performance. Legal rules may provide frameworks for relevant management compensation schemes in this regard. With respect to the relationship between majority and minority shareholders loyalty is based on a sharing rule whereby the agent's returns are tied to those of the principal (the principle of equal treatment, for example).

The choice of legal strategies differs depending on the relevant institutional environment. Governance strategies may be appropriate where the principals are able to overcome coordination problems and pursue their rights independently with the support of available legal institutions. The right to appoint and remove directors can be effective in an environment with large shareholders, for example. On the other hand, there is some evidence that in environments with dispersed shareholders directors may become isolated from the effects of shareholder voting[196].

Regulatory strategies may be appropriate, on the other hand, where principals are not able to effectively pursue their interests. Diversified minority shareholders, for example, may not be in a position to defend their interests independently, and would benefit from regulatory

[192] *Id.*
[193] *Id.*, referred to as "Affiliation Terms".
[194] Armour, Hansmann & Kraakman (2009), *supra* note 129, at 42.
[195] *See* Sofie Cools, *The Real Difference in Corporate Law between the United States and Continental Europe: Distribution of Powers* (Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series, 490, 2004), *available at* http://lsr.nellco.org/harvard_olin/490.
[196] *See* MARK ROE, STRONG MANAGERS, WEAK OWNERS – THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1996).

strategies being pursued. Shareholders with small diversified investments may not have sufficient stakes at risk to justify taking on monitoring costs. Moreover, the cost is generally carried by the individual shareholder whereas the outcome would benefit all shareholders. These coordination problems often require legal strategies based on rules and standards or monitoring by supervisory authorities, for example.

Ex ante strategies are important for allowing economic actors to assess in advance the legal framework for their economically relevant agency relationships. However, ex ante strategies are also inflexible and may not allow a more advanced assessment of complex agency relationships. Ex post strategies allow for a more detailed assessment of the behavior of economic actors, but require advanced legal institutions, such as courts that can effectively and reliably adjudicate these types of issues.

The choice of a specific legal strategy to address regulatory concerns does not need to be exclusive. Different legal strategies could be used together where a specific mechanism might be insufficient due to weak enforcement, for example.

Applied to corporate governance regulation in an environment with concentrated ownership, for example, the above would suggest that politically dominant controlling shareholders should be able to pursue their interests independently. Consequently, governance strategies would likely be used with respect to the agency relationship between shareholders and managers. In this environment shareholders will likely be able to – de facto – enforce their rights at general meetings of shareholders. Minority shareholders, however, are not in a similar position to defend their interests and with respect to the relationship between controlling shareholders and minority shareholders regulatory strategies might be observed. Thus standards for director behavior are important in that context, for example. Standards may also be needed to protect minority shareholders from potential abuse by controlling shareholders. Entry and exit rights would also be important for minority shareholders, and are reflected in mandatory bid rules, for example. Similarly, large shareholders might be able to enforce their rights independently through the courts or otherwise whereas minority shareholders would need to refer to public enforcement through supervisory authorities. An interesting question is whether some governance strategies might also be suitable for the relationship between controlling shareholders and minority shareholders. In particular, incentive structures might be suitable for protecting the interests of large groups with coordination challenges. For example, regulation might seek not to attempt to provide mechanisms that challenge the control of large shareholders, but instead look to incentivize controlling shareholders to transfer control when a change of ownership structure is called for.

It is important to understand how the choice of legal strategies can be relevant for the effectiveness of regulation. The application of legal strategies not suited for the environment results in ineffective or even irrelevant regulation. Allowing for legal action through the courts, for example, may be less relevant if there are clear disincentives for potential plaintiffs to pursue claims. In many cases the interest of individual plaintiffs is too small or the quality of the court systems too unreliable (including duration of process) to justify the risks related to pursuing such action.

In several cases, legal strategies have been introduced in EU corporate governance regulation that have not been suited to the varied systems of corporate governance throughout the EU. The break-through rule introduced as an optional element in connection with the Takeover Directive, for example, has been argued not to have been adapted to its intended use in a concentrated ownership environment, and would more likely have resulted in increased ownership concentration instead of the opposite.

B. Political Aspects of Choosing Legal Strategies

The political environment must also be considered in the choice of legal strategies. Regulatory goals are based on policy agendas, which can be the results of political compromises. However, sometimes the design of regulation or the choice of legal strategy can affect the feasibility of introducing regulatory initiatives. Interest groups may of course resist regulatory initiatives altogether. There may be a difference in, on the one hand, a conceptual conflict between proposed regulatory initiatives and the interests of affected constituents and, on the other hand, conflicts between specific regulatory measures and key premises of existing corporate governance systems. The Takeover Directive, for example, facilitated change of control and transferred some decision making authority from management and labor in this regard – triggering conceptual (political) concerns among those constituencies[197]. On the other hand, takeovers as such may be unproblematic for other constituencies, such as controlling shareholders, while the proposed break-through rule as a mechanism challenged their decision rights that can be seen as an elementary precondition for maintaining control blocks. It may be difficult to alleviate the concerns of management or labor with technical solutions, and political strategies may need to be considered instead. However, with regard to the break-through rule, alternative functionally equivalent mechanisms could have been considered instead. Instead of a break-through rule challenging the control implications of different share classes, the Commission might have pushed for caps on the differences on the consideration payable for shares of different classes, for example. It is not clear that the break-through rule is a workable regulatory tool altogether, but in its current form the rule certainly may have had counterintuitive effects in further entrenchment of control in environments with concentrated ownership[198]. This study does not propose that regulators did not consider such alternatives, but suggests that work should be continued not only to develop better awareness of these differences in regulatory processes, but also towards qualitative models for addressing these types of situations in EU legislative processes. Such models would include analysis of institutional environments and different legal strategies and regulatory tools for pursuing regulatory policies in these environments.

In many cases it is possible to pursue regulatory goals through different regulatory measures and mechanisms. Thus it may be possible to adapt the choice of legal strategy to take into account the political environment to some extent. The functional equivalency of alternative regulatory avenues can be considered and regulatory mechanisms chosen that are less controversial in light of the applicable institutional environment – as long as regulatory goals can be satisfactorily met.

The above highlights the importance of identifying the constituencies affected by proposed legal intervention and the political alliances that can be formed to allow intervention to pass the political process. The constituencies that may be supportive of intervention may not be the same in different jurisdictions. It may also be important to seek regulatory solutions that balance policy requirements with the key concerns of politically influential constituencies. If possible, regulation should be designed to achieve intended policy goals while taking these concerns into account.

---

[197] Horn (2011), *supra* note 113, at 115 and 118.
[198] *See* John C. Coates IV (2003), *supra* note 35.

C. Regulatory Mechanisms in the EU Environment

The EU has a limited range of options for pursuing its regulatory goals in the field of corporate governance. These vary from enforcing EU treaty freedoms through the European Courts to introducing legal instruments and even to non-legal measures, such as recommendations or studies.

A key question in considering the preconditions for regulatory intervention is whether the matter at hand requires a regulatory response at the EU level, or whether the appropriate avenue from the perspective of EU policy is negative harmonization through the courts and leaving the matter to be regulated at the national level. With respect to corporate governance regulation the assessment links to the harmonization-competition debate. The assumption underlying positive harmonization is that "(c)entralized regulation, or positive integration, furthers market integration by establishing a framework of common rules in all Member States"[199]. Integration can be pursued through the courts, of course, by enforcing the EU treaty freedoms. The precedents of the ECJ in the field of corporate law have provided an important basis for interpreting EU treaty freedoms, and have had a considerable effect on the development of EU corporate law. In fact, negative integration and regulatory competition have been associated with a market oriented or laissez-faire approach to corporate regulation[200]. Generally negative integration limited to enforcing treaty freedoms would result in deregulation at the national level as incompatible national rules would be trumped by treaty freedoms. Also, this approach relies less on political decision making and more on an increased role of the ECJ. Positive integration through harmonization initiatives, on the other hand, always requires sufficient political support, whereas the effects of such harmonization initiative can vary depending on the policies pursued at the supranational level[201]. In this sense different regulatory approaches to developing corporate governance regulation in the EU – harmonization and regulatory competition –have significant political implications. The different approaches are linked to expected regulatory outcomes and reflect underlying political preferences. However, negative integration may not be sufficiently effective for the purposes of the Commission's regulatory goals. Considerable national lock-ins remain with respect to companies, which are subject to a plethora of regulation varying from labor regulation to taxation. Moreover, while the benefits of harmonization can certainly be debated, some criticism of EU harmonization of corporate law is also self-serving and originates from interested constituencies who have been able to dominate domestic regulatory policy to serve their self-interest, but find the political dynamic at the EU level more challenging in this regard[202]. Regulatory competition in the EU is still incomplete, and cannot be relied on to provide a mechanism for EU wide regulatory development. Thus, harmonization remains a relevant avenue for pursuing EU policies in the field of company law.

Regulatory Instruments

To the extent that positive harmonization is pursued, there is a limited portfolio of alternatives available at the EU level. For the purposes of corporate governance regulation, relevant regulatory instruments mainly include directives, regulations and recommendations[203].

---

[199] Johnston (2009), *supra* note 9, at 115 - 116.
[200] *Id.*
[201] *Id.* at 115-116.
[202] *See* Ferrarini & Miller (2009), *supra* note 8, at 15.
[203] Article 288, Treaty of the Functioning of the European Union, 2007.

Directives are binding "as to the result to be achieved", but require implementation at the national level. This can result in differences in how EU level regulation is interpreted across the EU. With respect to directives related to corporate governance, the EU Commission has conducted regular reviews of how directives have been implemented, and considered whether further action has been warranted if interpretations vary, or if implementation has been unsatisfactory. EU Regulations are directly applicable and no national measures are required in this regard. The EU Commission has also introduced recommendations on management remuneration, for example, focusing on shareholder participation in the approval of remuneration[204].

Adapting Regulatory Initiatives

There are several mechanisms that can be used to adapt regulatory intervention to existing circumstances, or to find appropriate compromises. With respect to directives, optionality has been used to allow the regulatory instrument to be adapted to local systems –as a result of political compromise, for example. In the case of the Takeover Directive, implementation of the break-through rule was optional, but member states had to provide means for individual firms to adopt the rule. "Grandfathering" is also a mechanism often advocated when introducing new regulation that may challenge existing prevalent structures. This would entail that existing structures can be maintained, but new ones must comply with the new regulatory initiative. Recommendations on best practices can be used to bring increased transparency on phenomena and thereby allow market or political interests to address possible concerns. In this regard comparative studies conducted at the EU level can also bring national differences to light and allow interest groups to react to possible concerns.

Allowing for regulatory solutions in relation to EU corporate governance regulation that are adapted to specific governance systems has been associated with the concept of reflexive governance. The view taken is that allowing diversity among member states can be a resource when combined with more open methods of coordination[205]. The concept of reflexive governance is based on the notion that regulatory intervention are likely to be more successful when they induce group representation and participation by social actors and "encourage autonomous processes of adjustment…rather than to intervene by imposing particular distributive outcomes"[206]. In this model, regulation should focus on establishing processes for developing regulation through group participation[207]. In the context of supranational regulation, including EU harmonization, "transnational standards would seek to promote diverse, local-level approaches to regulatory problems by creating a space for autonomous solutions to emerge"[208]. Different ways have been identified in which EU law can be deemed

[204] Recommendation 2009/384 EC and Recommendation 2009/385/EC.
[205] Simon Deakin, *Reflexive Governance and European Company Law* (Centre for Business Research, University of Cambridge, Working Paper No. 346, 2007, *available at* http://ssrn.com/abstract=1002678.
[206] Simon Deakin, *Regulatory Competition versus Harmonisation in European Company Law* (Centre for Business Research, University of Cambridge, Working Paper No. 163, 2000), *available at* http://www.cbr.cam.ac.uk/pdf/wp163.pdf.
[207] For a typology of reflexive regulation see J. Lenoble & M. Maesschalck, *Beyond Neo-Institutionalist and Pragmatist Approaches to Governance* (Reflexive Governance in the Public Interest Working Paper Series REFGOV-SGI/TNU-1), 2006, *available at* http://iap6.cpdr.ucl.ac.be/docs/TNU/WP-PAI.VI.06-TNU-1.EN.pdf.
[208] *See* Simon Deakin (2000), *supra* note 206.

to have adopted a reflexive approach to regulating national legal systems[209]. For example, allowing member states the option to apply certain provisions of EU level regulation steers the regulatory capacity at the national level by limiting the choice of optionality and yet allowing member states to retain central national structures. Minimum harmonization where member states can impose national requirements beyond harmonized levels but within the framework of the EU treaties can be seen in the same light. Soft law regulation based on recommendation and standards also provide a model for coordination. In the field of corporate governance, for example, such an approach has been emerging at the EU level in the form of recommendations issued by the EU Commission on independent directors[210] and on the remuneration of directors[211]. Other forms aligned with the concept of "reflexive regulation" include the adoption of harmonized procedural rules setting out the framework for how social actors shall interact, and harmonized disclosure rules, which allow for the information to be incorporated in market prices, for example[212].

The challenge of reflexive governance is that this approach may, in fact, allow for entrenched national structures to thrive, and does not necessarily facilitate the development of supranational regulatory policies. To the extent that reflexive governance promotes processes for the engagement of social actors it is possible that this would serve to support existing national regulatory dynamics among affected interest groups. This would allow politically dominant groups to maintain entrenched positions and status quo. It has been noted, in this regard, that the implementation of the Takeover Directive, for example, may have resulted in a less takeover-friendly environment than earlier in some jurisdictions[213]. A reflexive governance –approach may provide avenues to explore regulatory alternatives in areas with considerable institutional differences among affected jurisdictions. It does not, however, seem to provide adequate tools for efficiently pursuing specific EU level policies at the national level.

The study now turns to considering the design of legal strategies at the EU level with respect to dealing with control transactions and concentrated ownership. I will consider the kind of legal strategies that address the relevant agency concerns, but will also take into consideration the special characteristics of EU regulation discussed above.

D. DEVELOPING ENHANCED STRATEGIES FOR EU CORPORATE GOVERNANCE REGULATION

The adoption of supranational regulation will pose challenges in cases where the relevant institutional environment differs across the affected jurisdictions. As EU level regulation in many respects relies on national enforcement mechanisms, there is also a risk that regulation will be both interpreted and enforced in different ways across the EU. These characteristics, among other, need to be taken into account when choosing legal strategies at the EU level.

[209] *See* Michael Dougan, *Vive la Différence: Exploring the Legal Framework for Reflexive Harmonization within the Single European Market, in* ANNUAL REVIEW OF GERMAN AND EUROPEAN LAW VOLUME 1, 113- 165 (Russell Miller & Peer Zumbansen, eds., 2003).

[210] Commission Recommendation of 15 February 2005 on the Role of Non-executive or Supervisory Directors of Listed Companies and on the Committees of the (Supervisory) Board (2005/162/EC), O.J. L 52/51.

[211] Commission Recommendation of 14 December 2004 Fostering an Appropriate Regime for the Remuneration of Directors of Listed Companies (2004/913/EC), O.J. L 385/55.

[212] Johnston (2009), *supra* note 9, at 240-242.

[213] Armour & Ringe (2011), *supra* note 1, at 39; *see also* Paul Davies, Edmund-Philippe Schuster & Emilie Van de Walle de Ghelcke, *The Takeover Directive as a Protectionist Tool?* (ECGI Law Working Paper 141, 2010), *available at* http://ssrn.com/abstract=1554616.

Below, we shall discuss some of the characteristics of a supranational environment in the context of choosing legal strategies for supranational regulatory intervention.

Regulatory Initiatives and Institutional Path Dependence

It has been noted that it has been easier to introduce EU regulation in areas where national level institutions have not developed. There is less resistance in introducing new regulation when there are no national level structures or interest groups that are immediately challenged. It has been argued that there has been less resistance to the introduction of EU level financial services regulation, for example, as many EU member states did not have developed or active markets and have few national structures to defend[214]. However, distinct company law and corporate governance systems have developed at the national level in the EU member states, and introducing change will meet political resistance. Legal responses to such resistance include the opt-in and opt-out systems, as has been discussed. However, other corresponding measures include grandfathering and dual regulatory systems, for example. These allow existing structures to be retained, while preventing such structures to be created after the adoption of the new regulation.

Enforcement - the Effects of Regulation

There has been concern that the implementation of EU corporate regulation has not been uniform and that the enforcement of EU regulations has varied significantly among the member states[215]. These concerns also need to be taken into account in the design of regulatory mechanisms. Enforcement issues are not unique to supranational regulation, but need to be considered in the design of legal strategies in general. However, the variation of enforcement at the local level does add to the complexity of EU level regulation. In this respect, the EU cannot readily rely of the efficiency of national enforcement mechanisms for the purposes of harmonization. The EU does provide a framework for monitoring enforcement in the form of its own court system. The precedents of the ECJ in the field of corporate law have provided an important basis for interpreting EU level corporate regulation, and have had a considerable effect on the development of EU corporate law. However, corporate matters are still dealt with by national court systems with varying expertise through the European Union. In fact, Gilson and Schwartz have argued that matters relating to the relationship between majority and minority shareholders, for example, be directly taken up with a European level corporate court[216]. The initiative may well be applauded, and the English courts with experience from corporate matters (mainly in London), for example, could well provide a basis for developing a European wide corporate court system. However, such court systems are not currently available. Moreover, as legal processes are time consuming and financial interests may be great and matters urgent, the court framework leaves much to be desired. Also, reliance on courts may require that aggrieved parties are appropriately incentivized to use the courts (or at least that there are no significant disincentives to do so). Typically potential plaintiff minority shareholders, for example, will face coordination problems in having only a limited financial interest proportional to their level of shareholding while carrying the full risk of legal costs for the dispute at hand.

[214] Armour & Ringe (2011), *supra* note 1, at 27.
[215] *See* Enriques & Gatti (2009), *supra* note 4.
[216] *See* Ronald Gilson & Alan Schwartz, *Constraints on Private Benefits of Control: Ex Ante Control Mechanisms versus Ex Post Transaction Review*, 169 JITE 160 (2012).

Enhanced Legal Strategies

The discussion above suggests that there are several factors to consider in designing new EU level corporate governance regulation. Below, this chapter provides a brief summary of these factors.

The legislative design process should start with the analysis of the appropriate legal strategy based on the ability of different constituencies to overcome coordination problems. To the extent that regulation is introduced to enhance the interests of minority shareholders, for example, regulatory strategies should be applied (instead of governance strategies). The analysis would then turn to whether instruments applied ex ante (rules) or ex post (standards) would be more appropriate. The choice would depend on, among other, how the regulation can be enforced. At this point the special characteristics of EU level regulation must be taken into account. Ex ante legal strategies that target a specific form of ownership or governance may be counterproductive especially in the EU context. Gilson & Schwartz argue, for example, that an efficient ex post legal strategy is superior to ex ante regulatory strategies that would impede the use of legal solutions that may be efficient in different markets[217].

However, at the EU level it needs to be taken into account that the nature and quality of legal systems and institutions varies across the jurisdictions. The EU legislators have to consider that corporate governance matters will be subject to adjudication in very different legal systems by very different legal institutions. Moreover, as discussed, minority shareholders may lack sufficient incentives to enforce their rights independently. However, even in these circumstances it may be possible to increase the effectiveness of legal standards by regulating the premises for legal adjudication. The enforcement of standards could be enhanced by setting special criteria, such as an "entire fairness" standard or by using rebuttable assumptions with regard to related party transactions. Changing the burden of proof in this way may affect how standards can be enforced. The use of certain governance strategies could be facilitated in the same way.

The next step of the design process would incorporate considerations related to institutional differences and differences in the political economy. The background for issuing principles-based directives at the EU level has been to allow member states to implement the directives in ways that fit the characteristics of the national legal system, for example. In the Takeover Directive, member states were allowed to elect whether to implement some of the more controversial provisions – the neutrality rule and the break-through rule (opt-in/opt-out). The directive also allowed member states latitude as to the relevant threshold for triggering squeeze out rights and obligations. The optionality provided for in the Takeover Directive was an ad hoc compromise to resolve a political gridlock, but may not be a failed mechanism as such. However, the optionality provided in the Takeover Directive may not have been sufficiently detailed. The case can be made for introducing functionally equivalent rules where policy goals are set and pursued through a variety of legal strategies and regulatory mechanisms tailored for different environments and governance systems. In designing EU level regulation it may be important to look to the underlying regulatory concerns rather than formal corporate governance structures and to find legal strategies that best address the relevant regulatory concern in the given institutional context. Instead of opt-in and opt-out mechanisms it could be contemplated that EU directives provide for a limited menu of regulatory choices, or the directives can provide for different rules to be applied in different

[217] *Id.*

contexts, for example. Also, the standards based strategies discussed above allow for an ex post assessment of agent behavior and may provide an instrument that is not dependent on formal governance structures. In this way, similar policy goals can be pursued through the EU while allowing for solutions adapted to specific governance models to be applied at the national level. It has also been proposed that optionality would be introduced at the level of individual companies with respect to takeover regulation, for example[218].

As discussed, regulation must not only be better adapted to the institutional environment; it must also be politically feasible to introduce the relevant regulation. An important aspect in this regard is how the regulation affects the interests of politically dominant constituencies. These constituencies are likely to be less opposed to new initiatives that do not directly challenge their position. A factor that affects the choice of legal strategies and regulatory design is how regulation can avoid challenging the key parameters of existing governance systems. Concentrated ownership systems may rely on monitoring by controlling shareholders, who also seek to defend their control positions. This also suggests that ex ante rulemaking restricting specific forms of governance might face significant political opposition. Instead, for example, general standards addressing the potential abuse of agency relationships within a given governance system might be more appropriate. Controlling shareholders are likely to be more opposed to regulation directly challenging their control than they would be to standards restricting abuse of that control.

In addition to regulatory design, the legislator may consider alternative regulatory measures (i.e. grandfathering, regulatory dualism or other soft law measures). Also, instead of allowing for national level opt-outs, the EU legislator could introduce limited menus of regulatory alternatives. These alternatives could be applied either at the national level or even at the level of individual companies.

Finally, there is only a limited scope of regulatory instruments available at the EU level, including regulations, directives and recommendations. However, the EU can also use less formal measures, including green papers or studies, to analyse and increase transparency with respect to corporate governance in the EU member states. Such initiatives can increase the salience of the concerns raised by the EU Commission and allow market participants to compare practices in the member states.

The chart below presents a summary of considerations related to choice of legal strategies and regulatory mechanisms.

EU Corporate Governance / Assessment for Regulatory Design		
Steps	**Choices**	**Relevant Considerations**
Choice of Type of Legal Strategy	Regulatory Strategies Governance Strategies	Consider coordination problems of affected constituencies;
Choice of Type of Mechanism	Ex ante / Ex post Rules / Standards Entry / Exit	Consider type of mechanism(s) in light of environment for application, and quality of

[218] *See* Luca Enriques, Ronald J. Gilson & Alessio M. Pacces, *The Case for an Unbiased Takeover Law (With an Application to the European Union)*, 4 HARVARD BUS. L.R. 85 (2014).

	Selection / Removal Initiative right / veto right Trusteeship / Reward	available legal institutions. Consider need for combing or enhancing applied mechanisms.
Political Economy Consideration of Mechanisms	Revisit mechanisms above; Consider applying alternative regulatory mechanisms: - Limited menus - Default rules with optionality - Opt-ins / opt-outs at national or company level - Regulatory dualism - Grandfathering	Assess initial choice of mechanism in light of political economy: Avoid mechanisms that challenge premises of the corporate governance system.
Choice of EU Level Instruments	Regulations / Directives / Recommendations Green Paper / Other studies.	Choose appropriate instrument based on type of national measures required; Consider whether "soft law" approaches are appropriate to raise transparency at initial phases of regulatory action.

V. DESIGNING EU CORPORATE GOVERNANCE REGULATION

Recent EU corporate governance initiatives have originated, in part, from the reactions to the global financial crisis. They have been preceded by experts' reports and hearings, which have then resulted in green papers allowing for interested parties to comment on different alternatives for regulatory intervention. However, on many occasions EU level regulatory proposals are based on experiences and regulatory solutions in specific jurisdictions[219]. Sufficient attention has not always been given to how those mechanisms are adapted to the varied environments throughout the EU member states. Political opposition to such proposals has also strengthened to the extent that the proposals have challenged key parameters of the relevant corporate governance systems.

In preparing policy and in introducing regulation to implement such policy it is important to understand the overall policy environment and the conditions and the institutional arrangements affecting the policy area[220]. It is also important to identify the relevant actors and interest groups and the situations where policies will be applied. Finally, the patterns of interaction and the information available to relevant actors should be fully understood. These preconditions have been recognized in institutional analysis and, in fact, efforts have been made to develop qualitative models for the design of policy, where the above factors have

[219] *See, inter alia,* Johnston (2009), *supra* note 9, at 247 and 266.
[220] ELINOR OSTROM, UNDERSTANDING INSTITUTIONAL DIVERSITY, 7-15 (2005).

been identified as the basic elements for analysis[221]. The framework allows for policy design that recognizes the institutional environment and may help in adapting regulatory intervention to this environment. From this perspective, this chapter seeks to summarize matters related to the policy environment to be considered in choosing legal strategies and regulatory designs with respect to EU level corporate governance regulation. For the purposes of this study, it is particularly interesting and important to consider the factors that are characteristic to the dynamics of policy in the context of the EU. Identifying and analyzing these factors are also essential in work towards developing a qualitative model of EU policy design.

The Policy Environment

As discussed, the corporate governance policy area in the EU remains varied with different corporate ownership structures and corporate governance systems (with complimentary institutions). Industrial structures and the dynamics among corporate constituencies differ, as do the political and legal institutions whereby constituencies coordinate the interests and enforce their rights. Corporate governance systems have developed over time and reflect local circumstances and political dynamics; they may also be entrenched.

With respect to EU policy this entails, among other, that EU wide regulation can have different and unintended effects in different regions. The chosen legal strategies can conflict with or challenge complementary institutions that have developed in a given corporate governance system. The legitimacy of a variety of corporate governance models should be recognized at the EU level. Legal strategies should be adapted to institutional environment to have desired effects, and that a functional approach to regulatory initiatives should be emphasized. Different corporate governance models should not be disenfranchised by EU-wide regulatory mechanisms. The policy goals of regulatory initiatives should be considered and different regulatory mechanisms should be applied that address the relevant concerns in different environments. Regulatory designs that challenge or contradict the functions of complementary institutions that have evolved should be avoided. For example, instead of directly challenging the position of controlling shareholders (through break-through rules, for example, or extensive veto rights for minority shareholders), increased transparency or legal standards can be considered instead. The chosen mechanism should address the potential for abuse in the relevant corporate environment.

The competitiveness of EU listed companies remains a concern with increased globalization and alternative means of corporate financing (including private equity). As economic interaction and cross-border investment among member states increases, the need for coordination is ever more important. An important aspect with respect to corporate governance regulation is the adaptability of corporate enterprise to changing circumstances. Corporate governance is easily entrenched and regulatory means may be required to address this concern.

Actors and Interest Groups

The key actors in the policy area include the core corporate constituencies; i.e. shareholders, management and employees. Other providers of corporate financing, mainly banks and other lending institutions, are also likely to participate in the "market for regulation" with regard to corporate governance regulation. Key actors also include politically elected officials, who

[221] Id.; *see also* Elinor Ostrom, *Background on the Institutional Analysis and Development Framework*, 39 POLICY STUDIES J. 7 (2011).

may need to promote corporate governance agendas that have a high political salience. The relevant interest groups are not homogenous, however. For example, controlling shareholders (i.e. corporate "insiders") are often seen to represent clearly different policy agendas than do institutional investors and retail investors (i.e. corporate "outsiders"). The interests of labor are also diverged in a varied political economy such as the EU with different industrial structures and different pension systems. The dynamic is also affected by regional differences in corporate governance systems. To the extent that proposals challenge regionally prevalent corporate governance models this will likely result in regional alliances trying to block the proposal in the legislative process (both in the Council and in the EU Parliament). These factors can create further cleavages among interest groups.

For the purposes of policy-making it is important to understand the type of politics involved with respect to the regulatory initiatives at hand – i.e. whether they are driven by small interest groups against each other (management vs. controlling shareholders), whether interest groups are seeking to promote their own interests (client politics) or prevent initiatives to promote the interests of dispersed groups such as minority shareholders (entrepreneurial politics). Interest group influence can be considerable, and in many cases their concerns have been legitimate as initiatives have had even confiscatory elements. In developing policy and regulation the key concerns of key constituents should be identified and regulatory designs should be chosen that promote the regulatory goals but that do not undermine the basis of different governance systems thereby decreasing political resistance. If necessary, alternative regulatory measures should be considered, such as grandfathering, soft law, partial harmonization, recommendations, or increased transparency. Issues driven by political salience should be identified as such; the effects of high salience policies on the premises for business enterprise should be evaluated, and appropriate regulatory measures used that do not impact competitiveness, such as enhanced transparency. In fact, high-salience matters have been addressed mainly through increased transparency requirements (such as say-on-pay and board diversity issues).

The dynamics among key corporate constituencies can be seen to result in both interest group politics and client politics affecting the dynamics of policy making[222]. However, corporate insiders have been argued to have a relatively stronger position with regard to national level corporate governance regulation, while supranational regulation may provide economies of scale allowing corporate outsiders (investors) to coordinate actions at the EU level[223]. However, the multilevel governance model of the EU is likely to result in no single interest group being able to monopolize policy and in entrepreneurial policy-making by the EU Commission remaining important[224]. For legal strategies this dynamic means that the role of the Commission as a policy entrepreneur remains important.

Patterns of Interaction

Corporate governance reflects the patterns of interaction among corporate constituencies. As discussed, corporate governance can be seen as a framework for bargaining among corporate constituencies with respect to terms and conditions of participation in corporate enterprise. The patterns of financial contracting are path dependent, and the dynamics of bargaining vary, resulting in a variety of corporate governance outcomes.

---

[222] Giandomenico Majone, *The European Commission as Regulator, in* REGULATING EUROPE, *supra* note 111, at 76-77, and Young (2010), *supra* note 36, at 51.
[223] *See* Ferrarini & Miller (2009), *supra* note 8; see also Young (2007), *supra* note 119, at 384.
[224] Majone (1996), *supra* note 222, at 74-75, and Hix & Hoyland (2011), *supra* note 12, at 212.

Understood in the terms above, the field of corporate governance is broad. However, the focal points of corporate governance regulation relate to decision and cash-flow rights related to corporate enterprise – mainly in relation to the organization of and actions of the board of directors, general meetings of shareholders, as well as with respect to different types of related party transactions and transparency requirements of investors. The dynamics of decision making in corporations vary depending on the relevant corporate environment. As discussed, one of the key issues in this regard is related to the structure of corporate ownership. The relevant patterns of interaction among the corporate constituencies vary accordingly. For the purposes of choosing appropriate legal strategies, this means that it is vital to understand the relevant dynamic. Clearly, then, a prerequisite of successful EU level corporate governance regulation is a thorough understanding of patterns of interaction in different corporate governance systems in the EU.

EU Institutional Factors

The role and structure of the EU by itself includes factors that affect the dynamic of policy making and the effectiveness of EU regulation. As discussed the EU has resulted in a multilevel system of governance, where the authority of the EU and the regulatory dynamic vary depending on the policy area in question. This dynamic evolves and has not reached any equilibrium[225].

The legal system of the EU does give EU level regulations a strong position vis-à-vis the EU member states. However, the EU largely relies on member states for enforcing its rules and the quality of the relevant legal institutions may vary considerably through the EU. Therefore, it may not always be advantageous to introduce legal strategies reliant on enforcement through the courts, for example (i.e. standards-based strategies, for example).

The institutional structures of the EU have considerable impact on policy-making. The ability to set policy agendas and to introduce regulation provides for entrepreneurial authority for the EU Commission, albeit within institutional limitations defined by the dynamics of the EU Council and the EU Parliament. Regulatory initiatives must be politically feasible and so identifying potential political alliances is vital in order to pursue regulatory initiatives successfully. Alliances can be based on regional cleavages or on traditional political cleavages and can vary depending on the proposed regulatory actions. These are ordinary workings of politics. The Commission can use its agenda setting authority to form regulatory packages designed to maximize political support and to minimize resistance. However, it is not clear that regulatory design is sufficiently used as an element in working through these political dynamics. In this context regulatory initiatives can be adapted based on the political dynamic by choosing regulatory mechanisms that do not unnecessarily confront key concerns of interest groups. This should decrease political resistance and allow for the pursuit of policy goals.

A related aspect is the variety of regulatory mechanisms available at the EU level, i.e. directives, regulations and recommendations, as well as adaptive measures including optionality, grandfathering, dual-regimes, and soft-law approaches.

---

[225] Giandomenico Majone, *The Future of Regulation in Europe, in* REGULATING EUROPE, *supra* note 111, at 265-266.

Evaluative Criteria

The policy environment and the interactions therein can be evaluated from different perspectives, both internal and external, including economic efficiency, redistributive effects and accountability, for example[226]. Importantly, the framework approach allows an analysis of how these different aspects are affected in relative terms by the different elements described above. This results in more transparency in legislative processes.

The summary above is mainly intended to demonstrate some of the underlying elements of the dynamics of EU corporate governance regulation. However, in this regard the summary also represents basic elements of a qualitative model for policy making and regulatory design with respect to EU corporate governance regulation – with an emphasis on regulatory design. The study recognizes that corporate governance regulation may not be directly comparable to many other policy programs. The assets subject to regulation include decision making rights to corporate enterprise rather than public goods. Nevertheless, the political and legislative dynamic has similar aspects. Developing such a model may provide better tools for both understanding EU regulation and for developing legal strategies at the EU level. The different elements are summarized in the annex hereto.

VI. CONCLUSIONS

As economic interaction across the EU has increased, so has the significance of EU level corporate governance regulation[227]. In fact, European corporate law has faced a revival[228] and the EU will likely continue be a significant source of corporate regulation, as the corporate environment becomes increasingly international. Understanding the dynamics of EU regulation and developing the EU approach to corporate governance regulation thus remain important ventures.

It is clear that supranational regulatory intervention is far more challenging than regulation at the national level. The variety and scale of economic and political environments increases significantly, raising the complexity of designing, introducing and executing policy. Also, the shift from established national governance systems to regulation through new supranational institutions with an evolving political dynamic will naturally raise complex challenges in itself. The institutions of the EU, for example, are relatively young compared to those at the national level, and the political dynamics of the EU is evolving. Much work is required to develop policy-making and regulation in this environment.

In these circumstances it is important to develop tools for analysing and improving EU policy-making. A precondition for this is a better understanding of the underlying political dynamics. This study has emphasised the notion that law and politics cannot be studied independently of each other if the goal is to properly understand the dynamics of legislation and legislative processes[229]. The dynamics of supranational regulation, and the effects of the institutional structure of the EU, must also be taken into account when considering the development of EU corporate governance regulation and appropriate legal strategies. The study has outlined the sphere of bargaining with respect to corporate governance regulation at

[226] Ostrom (2011), *supra* note 221, at 15-17.
[227] *See* Hopt (2015), *supra* note 1.
[228] *Id.* at 55.
[229] ANNA HYVÄRINEN, SUOMEN MAHDOLLISUUDET VAIKUTTAA EUROOPAN UNIONIN LAINSÄÄDÄNTÖMENETTELYYN [FINLAND'S POSSIBILITIES TO EXERT INFLUENCE IN EU-LAW MAKING] 7 (2015).

the EU level, and then analysed how the “market for regulation” functions at the EU level with respect to corporate governance regulation. The study has also made a contribution towards the development of a qualitative framework for analysing and developing EU corporate governance policy and regulation.

The qualitative model recognizes the importance of adapting legal strategies and the design of regulatory instruments to the relevant institutional environment. The model emphasizes the need to recognize the requirements of the variety of environments through the EU in EU level policy design. Importantly, however, the model also emphasizes the political aspects of policy-making. The dynamics of the legislative processes must also be brought into the model of policy-making so that the effects of institutional structures and politics are more transparent. It is also possible to design regulatory instruments and to choose legal strategies to decrease political resistance. If strategies and designs are developed so that they are better adapted to institutional differences it is possible to decrease, to some extent, unnecessary political resistance without compromising policy goals.

ANNEX

A QUALITATIVE FRAMEWORK FOR DEVELOPING EU CORPORATE GOVERNANCE REGULATION

EU Corporate Governance Regulation **Framework Elements**	**Considerations for Legal Strategies**
Policy Environment - Varied corporate environment (structure of ownership, type of prevalent shareholders) - Varied institutional environment (including industrial structures, dynamic among key actors, quality of legal institutions) - Organizational matters may have considerable economic consequences (adaptability to change, competitiveness) - Increasing economic interaction among different systems	- Legal strategies to be adapted to institutional environment for desired effect
Actors - Shareholders (controlling shareholders/entrepreneurs, institutional investors, retail investors), management/entrepreneurs, employees (with political cleavages among employee interest groups), politicians	- Identify key concerns of different actors in the policy arena - Identify cleavages within interest groups
Interaction and Main regulatory avenues - Interaction through the corporate governance framework (defined by the terns of financial contracting in a given institutional environment) - Focal points include board of directors, general meetings, related party transactions, transparency, tax laws, insolvency laws, external governance regulation (in high salience matters including board diversity, social responsibility, environmental issues)	- Corporate governance must be understood broadly and relevant avenues used for regulatory intervention (including insolvency and tax laws) - Identify drivers for regulatory initiatives (i.e. interest group politics, entrepreneurial politics, high-salience matters)
Institutional aspects - Multilevel governance model defines policy environment - Limited scope of available regulatory instruments and enforcement mechanisms - EU institutional dynamic (Commission, Council, Parliament)	- Identify expected political alliances in advance - Reflect key concerns in regulatory design - Apply alternative mechanisms, and enhanced legal strategies where needed
Resulting evaluative criteria - Economic efficiency (in the context of relevant institutional environment) - Redistributive effects - Accountability	- Clarify regulatory goals

CHAPTER 7

THE EU TAKEOVER DIRECTIVE UNDER REVIEW: DEVELOPING LEGAL STRATEGIES FOR CONCENTRATED OWNERSHIP

The EU Takeover Directive was introduced after a particularly long and convoluted legislative process. The controversies surrounding the directive reflected the significant differences in the ownership and governance systems of listed companies in the EU member states. The directive and the underlying legislative process provide insights into the dynamics of EU corporate governance regulation.

While the Takeover Directive has contributed to the harmonization of processes related to takeover bids across the EU, the directive has been criticized for inadequately addressing regulatory concerns related to concentrated ownership, and for not contributing to the development of a European market for corporate control. It has been argued that instead of facilitating takeovers, the mechanisms introduced in the directive may, in fact, have resulted in further shareholder entrenchment. The EU Commission has also reported that certain provisions of the directive addressing corporate control, such as mandatory bids and acting in concert, still raise some regulatory concerns. It may therefore be relevant to revisit the regulatory mechanisms used in the Takeover Directive.

This chapter argues that key provisions of the Takeover Directive were not adapted to an environment of concentrated ownership and introduces alternative regulatory proposals in this regard. The chapter also analyses legal strategies appropriate for EU level corporate governance regulation more generally. In this regard the chapter serves as a case study for the application of qualitative models for developing legal strategies at the EU level.

I. INTRODUCTION

Initiatives to harmonize corporate governance regulation at the level of the European Union[1] have been subject to much criticism over the years.[2] It has proved challenging to introduce EU-level regulatory models that take into account national differences in corporate governance systems. The effects of EU-level regulatory intervention may differ significantly among the member states, depending on the institutional environment. One of the key factors

---

[1] Regulation issued by the organs of the European Union is referred to hereinafter as EU regulation.

[2] *See* John Armour, *Who Should Make Corporate Law? EC Legislation versus Regulatory Competition* (ECGI - Law Working Paper No. 54, 2005), *available at* http://ssrn.com/abstract=860444 or http://dx.doi.org/10.2139/ssrn.860444; John Armour & Wolf-Georg Ringe, *European Company Law 1999-2010: Renaissance and Crisis* (ECGI – Law Working Paper No. 175/2011, Oxford Legal Studies Research Paper No. 63/2010), *available at* ttp://ssrn.com/abstract=1691688 or http://dx.doi.org/10.2139/ssrn.1691688; Luca Enriques, *Company Law Harmonization Reconsidered: What Role for the EC* (ECGI Law Working Paper No 53/2005), *available at* http://ssrn.com/abstract=850005; Luca Enriques & Matteo Gatti, *The Uneasy Case for Top-down Company Law Harmonization in the European Union*, 27:4 U. PA. J. INT'L ECON. L., 939-998 (2006), Gerard Hertig & Joseph A. McCahery, *Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition?* (ECGI Law Working Paper No 12/2003), *available at* http://ssrn.com/abstract=438431.

in this regard has been the varying structure of corporate ownership in the EU. For example, corporate governance solutions adapted to dispersed ownership may be ineffective in companies with concentrated ownership, where the controlling shareholder may in effect be able to unilaterally control the business of the corporation. This was also noted in connection with the adoption of the EU directive on takeovers (the "Takeover Directive").[3] The Takeover Directive was adopted in 2004 after a long legislative process subject to intense political pressure and compromise.[4] The controversies surrounding the directive reflected the significant differences in the ownership and governance systems of listed companies in the EU member states.[5] The political process that preceded the adoption of the Takeover Directive was particularly convoluted and provides insights into how interested constituencies pursue their interests through the EU political framework.[6]

While the Takeover Directive has contributed to the harmonization of processes related to takeover bids across the EU, the directive has been criticized for inadequately addressing regulatory concerns related to concentrated ownership, and for not contributing to the development of a European market for corporate control.[7] It has been argued that instead of facilitating takeovers, the mechanisms introduced in the directive may, in fact, result in further shareholder entrenchment in the context of concentrated ownership.[8] It may therefore be relevant to revisit the regulatory mechanisms used in the Takeover Directive. Recently, there has also been an emerging interest in the role of large shareholders in corporate governance,[9] making it salient to consider corporate regulation in the context of concentrated ownership.

EU Legal Strategies

This study assesses legal strategies used in regulating takeovers at the EU level in light of the varying structures of corporate ownership within the EU – and specifically in relation to concentrated ownership. The form and design of legal intervention are key factors for the efficient enforcement of policy. Strategies can vary from specific rules or standards to

---

[3] Directive 25/2004/EC of the European Parliament and of the Council of 21 April 2004 on Takeover Bids, 2004 O.J. (L142) [hereinafter Takeover Directive].
[4] See *Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids*, Brussels, January 10, 2002, *available at* http://ec.europa.eu/internal_market/company/docs/takeoverbids/2002-01-hlg-report_en.pdf [hereinafter High Level Group Report]; *see also* Ben Clift, *The Second Time as Farce? The EU takeover Directive, the Clash of Capitalisms and the Hamstrung Harmonization of European (and French) Corporate Governance*, 47 JCMS 55, 62-266 (2009), *and* ANDREW JOHNSTON, EC REGULATION OF CORPORATE GOVERNANCE, 268-280 (2009).
[5] Ownership in listed companies in the UK is typically widely dispersed with a strong institutional shareholder base. In Continental Europe, on the other hand, listed companies may have a single large shareholder or shareholder block with a controlling position. Controlling shareholders tend to be families, other corporations or governments rather than institutional shareholders. *See* Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate Ownership Around the World*, 54 J. FIN. 471, 491-93 (1999) [hereinafter La Porta et. al. (1999)].
[6] *See* Rolf Skog, *The Takeover Directive – an Endless Saga?*, 13 EUR. BUS. L REV. 301 (2002).
[7] *See* Thomas Papadopoulos, *The Mandatory Provisions of the EU Takeover Bid Directive and Their Deficiencies*, 1 LFMR 525 (2007).
[8] *See* John C. Coates IV, *Ownership, Takeovers and EU Law: How Contestable Should EU Corporations Be?* (ECGI Law Working Paper No. 11, 2003), *available at* http://ssrn.com/abstract=424720.
[9] *Report of the Reflection Group on the Future of EU Company Law* (April 5, 2011), *available at* http://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en.pdf [hereinafter Reflection Group Report (2012)], and *EU Commission Green Paper, The EU Corporate Governance Framework* COM(2011) 164 final (April 5, 2011) [hereinafter Corporate Governance Green Paper].

regulatory frameworks based on contractual arrangements. The enforcement of legal strategies can be based on private actions (court systems) or on public authorities, such as regulatory agencies. Different legal strategies may be required to ensure that legal intervention has the desired effect in different institutional environments. For example, the enforcement of certain legal strategies may depend on the quality of available court systems. Legal strategies are also likely to vary according to the applicable institutional environment to reflect the concerns and interests of dominant constituencies.

Legal strategies for addressing corporate governance relationships have been analysed in the corporate governance literature from the vantage point of national systems of corporate governance.[10] Legal intervention based on prescriptive rules and standards, often combined with disclosure obligations, is generally associated with efficient enforcement institutions, such as independent agencies and effective court systems. This type of intervention based on regulatory strategies may be called for when the affected constituencies are precluded from efficiently coordinating monitoring themselves – as is the case with shareholders in markets with a prevalence of dispersed ownership, for example. Other strategies based on the ability of the principals to exercise monitoring functions independently may be associated with less formal enforcement institutions. However, developing legal strategies in a supranational framework such as the EU creates special challenges, as the institutional environment varies across the affected jurisdictions. Where one strategy may be appropriate in some EU member states due to the structure of corporate ownership, another strategy may be called for in jurisdictions with a different corporate environment. The effects of EU-level regulation differ between member states depending on the relevant market structures and the broader institutional environment. In some cases the effects of EU regulation have been contradictory to its stated goals. This highlights the importance of the design of EU regulation and the choice of regulatory mechanisms, which may need to be tailored to different institutional environments.

Moreover, the EU's political institutions and the legislative processes for introducing EU regulation pose their own challenges for pursuing regulatory change at the EU level. Regulatory responses are the result of political processes and the efforts of affected constituencies pursuing their interest through the regulatory framework. In this respect, the study recognizes that corporate law is likely to reflect the institutional power of dominant corporate constituencies.[11] However, the EU framework has added considerable complexity to the political dynamic of regulatory development. The EU legislative process has its own characteristics with respect to interest group input and the political dynamics of the legislative process.[12] The EU's political institutions provide an alternative and additional framework to national institutions with respect to interest group input and the market for regulation, as understood in economic theories of regulation. The agendas and alliances of affected constituencies and interest groups may differ across the EU, creating a challenging political dynamic which must be taken into account when considering feasible strategies for EU-level regulatory intervention.

[10] John Armour, Henry Hansmann & Reinier Kraakman, *Agency Problems and Legal Strategies,* in REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW 35, 52 (2ND ED., 2009).

[11] John Armour, Henry Hansmann & Reinier Kraakman, *What is Corporate Law*?, in Kraakman et al. (2009), *supra* note 10, at 32.

[12] *See* Helen Callaghan, *How Multilevel Governance Affects the Clash of Capitalisms* (MPIfG Discussion Paper 08/5), *available at* http://www.mpifg.de/pu/mpifg_dp/dp08-5.pdf.

In summary, at the EU level it is not sufficient to address specific policy concerns within a given institutional setting. In fact, developing EU-level legal strategies poses at least two challenges missing from regulatory intervention at the national level. First, the effects of EU-level regulation vary depending on the institutional environment in different member states and, second, the political processes related to the enactment of EU regulation create a multilevel governance framework that affects how interest groups can best promote their agendas through regulatory intervention. These factors must also be taken into account when considering the development of EU corporate governance regulation and different mechanisms for regulating control transactions.

Concentrated Ownership and Takeover Regulation in the EU

Below, this study discusses the different factors affecting EU legal strategies for regulating control transactions. It considers the effect of the varying institutional landscape of corporate ownership, and specifically how concentrated ownership is a key characteristic to be taken into account when considering the choice of legal strategy and the effects of possible regulatory intervention.

Concentrated ownership and control enhancing mechanisms remain important features among publicly traded corporations in the EU.[13] These features raise specific regulatory concerns regarding the relationship between controlling and minority shareholders as well as the efficiency of corporate monitoring mechanisms.[14] However, while concentrated ownership and control enhancing mechanisms remain common features in the EU, after years of market integration it is still unclear whether they have been sufficiently taken into account in EU corporate governance and takeover regulation[15]. At the EU level there has also been concern that concentrated ownership and control enhancing mechanisms are, in themselves, an impediment to the development of active capital markets in the EU[16] and consequently even to economic growth.[17] The nature of EU initiatives suggests that concentrated ownership and control enhancing mechanisms have, to some extent, been deemed problematic *per se*, and that these structures are thus to be discouraged through regulatory intervention.[18] However, empirical studies have not established that concentrated ownership is by nature an inefficient

[13] *See* Mara Faccio & Larry H.P. Lang, *The Ultimate Ownership of Western European Corporations,* 65 JFE 365, (2002) [hereinafter Faccio & Lang (2002)]; *see also* Shearman & Sterling, *Proportionality Between Ownership and Control in EU Listed Companies* (External Study Commissioned by the European Commission, May 18, 2007, Open Call for Tender No MARKT/2006/15/F), *available at* ec.europa.eu/internal_market/company/docs/shareholders/study/final_report_en.pdf [hereinafter EU Proportionality Report].

[14] *See* Lucian A. Bebchuk, Reinier Kraakman & George Triantis, *Stock Pyramids, Cross-Ownership and Dual Class Equity: The Creation and Agency Costs of Separating Control from Cash Flow Rights 12* (Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series 249, 1999), *available at* http://lsr.nellco.org/harvard_olin/249: "The CMS [controlling minority structure] lacks the principal mechanisms that limit agency costs in other ownership structures. Unlike the DO [dispersed ownership] structures, where controlling management may have little equity but can be displaced, the controllers of CMS companies face neither proxy contents nor hostile takeovers."

[15] *See* Gerard Hertig & Joseph McCahery, Joseph A., *Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition?* (ECGI Law Working Paper No. 12/2003), *available at* http://ssrn.com/abstract=438431.

[16] *See* High Level Group Report*, supra* note 4.

[17] Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Schleifer & Robert Vishny, *Investor Protection and Corporate Governance*, 58 JSE, 3-27 (2000) [hereinafter La Porta et al. (2000)].

[18] *See* Erik Berglöf, & Mark Burkart, *European Takeover Regulation*, 18 ECON. POLICY 171 (2003), *available at* http://www.jstor.org/stable/1344656.

form of corporate ownership or that control enhancing structures necessarily provide an impediment to the development of a market for corporate control.[19] In fact, empirical studies in the EU report an association between high levels of corporate performance and ownership concentration[20] – and there are jurisdictions in the EU that report both high levels of concentrated ownership and active takeover markets.[21] Nor is it clear that regulatory intervention by itself would lead to an increase in dispersed ownership[22] or indeed that other forms of corporate ownership would be superior in EU markets. Given the prevalence of concentrated ownership and the entrenchment of control structures, it would seem more fruitful to focus on developing regulation that recognizes these features while addressing related regulatory concerns. Developing appropriate EU-level regulatory responses in this regard remains a relevant topic of research.

Efforts have been made at the EU level to address issues related to concentrated ownership in takeover and corporate governance regulation,[23] but such initiatives have met with resistance and their adoption has failed in certain key respects.[24] For instance, the Commission introduced a break-through rule[25] to address control structures in connection with the Takeover Directive and separately launched an initiative for a one-share-one-vote policy to be introduced for publicly traded corporations in the EU.[26] Both initiatives were heavily contested by affected interest groups and member states.[27] Ultimately, implementation of the break-through rule in the Takeover Directive was not mandatory, and the one-share-one-vote initiative was shelved before any final regulatory proposals were introduced[28]. It could be argued that these legal strategies were poorly chosen, as they provoked such political resistance. An assessment should thus be made of whether the same policy goals could have been achieved with other mechanisms of less concern to key constituencies.

It has also been argued that the regulatory mechanisms chosen by the EU Commission to address issues arising in the context of concentrated ownership and control enhancing structures are fundamentally flawed.[29] In many respects the Takeover Directive transplanted regulatory solutions from the United Kingdom – with largely a dispersed ownership structure

---

[19] *See* Harold Demsetz & Kenneth Lehn, *The Structure of Corporate Ownership: Causes and Consequences*, 93 J. OF POL. ECON. 1155 (1985); Torben Pedersen & Steen Thomsen, *Ownership Structure and Value of the Largest European Firms: The Importance of Owner Identity*, 7 J. OF MANAGEMENT AND GOVERNANCE, 27 (2003); Ann-Kristin Achleitner, André Betzer, Marc Goergen & Bastian Hinterramskogler, *Private Equity Acquisition of Continental European Firms - The Impact of Ownership and Control on the Likelihood on Being Taken Private* (Working paper, June 2010) *available at* http://ssrn.com/abstract=1319836.

[20] *See* Pedersen & Thomsen (2003), *supra* note 19.

[21] Most notably this is the case in Sweden. *See* Jonas Agnblad, Erik Berglöf, Peter Högfeldt & Helena Svancar, *Ownership and Control in Sweden: Strong Owners, Weak Minorities and Social Control, in* THE CONTROL OF CORPORATE EUROPE (Fabrizio Barca & Marco Becht, eds., 2001).

[22] *See* Magnus Henrekson & Ulf Jakobsson, *The Swedish Corporate Governance Model: Convergence, Persistence or Decline?,* 20 CORPORATE GOVERNANCE: AN INT´L REV. 212 (2012).

[23] *See* High Level Group Report, *supra* note 4.

[24] See Skog (2002), *supra* note 6.

[25] Takeover Directive, Art.11.

[26] *See* Commission of the European Communities, *Impact Assessment of the Proportionality Between Capital and Control in Listed Companies*, Commission Staff Working Document SEC(2007) 1705 (2007), *available at* http://ec.europa.eu/internal_market/company/docs/shareholders/impact_assessment_122007.pdf.

[27] *See* Skog, *supra* note 6.

[28] *Charlie McCreevy, Commissioner, Speech at the European Parliament's Legal Affairs Committee*, October 3, 2007, *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/592.

[29] *See* Paul Davies, Edmund-Philipp Schuster & Emilie van der Walle de Ghelcke, *The Takeover Directive as a Protectionist Tool?* (ECGI Law Working Paper No. 141/2010), *available at* http://ssrn.com/abstract=1554616.

and active takeover markets – to EU member states largely dominated by an environment of concentrated corporate ownership.[30] In this respect, regulation has not been tailored to the broader national institutional environment in most member states, and the effects of regulatory intervention can thus be expected to vary considerably. It has been argued, for example, that "similar regulatory changes may have very different effects within different corporate governance systems. For example, while in some countries the adoption of a specific takeover rule may lead toward more dispersed ownership, in others it may further reinforce the blockholder system."[31] This raises considerable challenges for the development of legal strategies for EU level regulation.

EU Takeover Regulation and Concentrated Ownership under Review

Developing EU-level regulatory approaches and mechanisms remains important, as EU harmonization efforts continue to affect the regulatory landscape and initiatives to harmonize EU corporate governance regulation are regularly subject to criticism.[32] It has been argued that EU efforts to provide a harmonized regulatory framework have resulted in ineffective regulation due both to the significant differences in ownership structure and governance systems that prevail among the member states, as well as to the characteristics of the political processes by which EU regulation is adopted. For example, some critics have questioned whether EU harmonization initiatives have actually been able to identify the market failures that member states have been unable or unwilling to regulate and whether they have provided superior uniform regulatory outcomes.[33] For example, Enriques argues that the EU has rarely been unable to correct market failures, instead producing regulation that entrenches the position of interested constituencies.[34] He also notes that in cases where EU initiatives are justified by the need for market integration, the result more often than not is that any gains from greater freedom of movement are lost through less flexible rules.[35] Other scholars argue that instead of adopting EU-level regulation in the field of corporate law, regulatory competition should be encouraged and EU efforts should focus, among others, on providing sufficient procedural protection for corporate stakeholders with respect to the competitive process.[36] However, scholars recognize that such changes in EU harmonization policy are unlikely to be introduced for some time.[37] Consequently, it remains important to identify problems related to EU harmonization and seek to develop both the design of EU regulatory mechanisms and the legislative processes involved in formulating and introducing EU regulation.

In this study I address the challenges to introducing EU-level regulatory models that take into account national differences in corporate governance systems. The effects of regulatory intervention can vary among member states depending on the broader national institutional environment, and harmonized regulation may not be aligned with the complementarities that

---

[30] Johnston (2009), *supra* note 4, at 268.
[31] Marc Goergen, Marina Martynova & Luc Renneboog, *Corporate Governance Convergence: Evidence from Takeover Regulation* 29 (ECGI working paper No. 33/2005), *available at* http://ssrn.com/abstract=709023.
[32] *Supra* note 2.
[33] *See* Enriques, *supra* note 2.
[34] *Id.* at 8, See also Luca Enriques, *EC Company Law Directives and Regulations: How Trivial Are They?* (ECGI Law Working Paper no. 39/2005) *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=730388
[35] Enriques, *supra* note 2, at 9-16.
[36] *See* Armour (2005), *supra* note 2 and Klaus Heine & Wolfgang Kerber, *European Corporate Laws, Regulatory Competition and Path Dependence*, 13 EUR. J. LAW & ECON. 47 (2002).
[37] *See* Enriques, *supra* note 2, at 22.

have evolved in each state. These issues are discussed below in the context of how the Takeover Directive addresses the implications of concentrated ownership for control transactions. The Commission has issued a comprehensive report on the application of the Takeover Directive in 2012, suggesting that there are still concerns with respect to certain matters addressed by the directive[38]. Interestingly, these relate, in particular, to concentrated ownership and control (mandatory bids and acting in concert, for example). Moreover, corporate governance issues related to concentrated ownership in general are of particular salience, as there has been an emerging interest in the role of large shareholders in corporate governance.[39] Provided regulatory concerns are satisfactorily met, concentrated ownership may be a competitive structure of corporate ownership, as there have been worries about the lack of shareholder engagement in publicly traded corporations with dispersed ownership.[40] Finally, the role of EU-level corporate governance regulation has again been subject to much debate and criticism after the introduction of recent regulatory initiatives,[41] and consideration of the challenges and problems specific to EU harmonization in the field of corporate governance is now timely.

This chapter of the study first provides a brief overview of concentrated ownership and control enhancing mechanisms in the EU and discusses current explanations for the prevalence of concentrated ownership (Section II). The study then turns to the corporate governance implications of concentrated ownership and discusses them in the context of control transactions (Section III). Next, the chapter discusses the legal strategies that can be used to address agency problems related to control transactions and concentrated ownership. The chapter also discusses strategies for addressing path dependence in connection with supranational regulation (Section IV). The chapter then assesses the EU-level regulatory responses to change of control and concentrated ownership adopted in the Takeover Directive (Section V). Building on this discussion, the chapter considers the feasibility of developing effective corporate governance regulation at the EU level and the possible factors underlying the current approach to corporate governance regulation in the EU (Section VI).

II. CONCENTRATED OWNERSHIP AND ITS IMPLICATIONS IN THE EU

There has been a long-running debate on the relationship between the structure of corporate ownership and corporate performance. Traditionally, concentrated ownership has been linked to poor economic performance and the extraction of private benefits of control by incumbent controlling shareholders at the cost of other shareholders. In particular, there has been concern about collusion between controlling shareholders and other corporate constituencies, such as employees, against the interests of outside shareholders[42]. The effects of dispersed ownership have been applauded, and it has been predicted that dispersed ownership with complimentary governance models will come to dominate over concentrated ownership. Nevertheless,

[38] Takeover Directive, art. 20; *See Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Application of Directive 2004/25/EC on Takeover Bids* (June 28, 2012), COM(2012) 347 final, *available at* http://ec.europa.eu/internal_market/company/docs/takeoverbids/COM2012_347_en.pdf [hereinafter EU Commission Takeover Directive Report (2012)].
[39] *Supra* note 9.
[40] Lynn Dallas, *Short-Termism, the Financial Crisis and Corporate Governance*, 37 J. CORP. L. 264 (2011).
[41] *See* Corporate Governance Green Paper, *supra* note 9.
[42] *See* Mark J. Roe, *The Institutions of Corporate Governance*, (Harvard Law School John M. Olin Center's Program on Corporate Governance Discussion Paper 488, 2004), *available at* http://www.law.harvard.edu/programs/olin_center/papers/pdf/Roe_488.pdf.

concentrated ownership remains prevalent in many regions of the EU, and empirical studies have been inconclusive as to the superiority of any specific structure of ownership. Studies have in fact found a positive relationship between concentrated ownership and firm performance.[43] However, for the purposes of this study, the more pertinent finding discussed below is how ownership structures and corporate control are prone to become entrenched, leading to incumbent structures prevailing even when they have become sub-optimal. For regulatory purposes, it seems that dealing with the entrenchment of controlling constituencies is a paramount concern regardless of the structure of ownership.

This section first provides a brief overview of the prevalence of concentrated ownership in Europe and a short discussion of studies related to the performance of companies with concentrated ownership. The study then discusses explanations for the persistence of different structures of corporate ownership, and considers the regulatory implications.

A. BACKGROUND

The prevalence of controlling shareholders

The structure of corporate ownership varies among EU member states. For example, on a general level, certain key distinctions in ownership models exist between the UK and continental Europe. Ownership in British listed companies is typically widely dispersed, with a strong institutional shareholder base.[44] In Continental Europe, on the other hand, listed companies often have a single large shareholder or shareholder block with a controlling stake. Companies often also have a minority shareholder who while not possessing an absolute majority still controls a significant block of the shares and votes in the company.[45] The level of ownership concentration in EU member states has decreased somewhat over the past decade but still remains high in many regions.[46]

Sample of Publicly Traded European Corporations (data excerpt)[47]

		Belgium	France	Germany	Italy	Nether-lands	Nordics	Spain
Ultimate voting rights	average	44.7	46.5	40.8	47.6	23.9	33.8	31.8
	median	40.1	49.0	39.5	51.6	14.2	32.4	30.4
Ultimate cash-flow rights	average	40.6	35.9	36.0	40.7	23.0	26.5	30.1
	median	34.9	33.8	32.0	45.4	14.2	22.0	28.4
Type of control (% of	Family	64.5%	63.2%	48.3%	76.9%	35.6%	43.5%	43.2%

[43] *See* Pedersen & Thomsen (2003), *supra* note 19.
[44] Faccio & Lang (2002), *supra* note 13.
[45] Marco Becht, *Reciprocity in Takeovers* (ECGI – Law Working Paper No. 14/2003), *available at* http://ssrn.com/abstract=463003.
[46] Christoph van der Elst, *Shareholder Mobility in Five European Countries* (ECGI - Law Working Paper 104/2008), available at http://ssrn.com/abstract=1123108 or http://dx.doi.org/10.2139/ssrn.1123108.
[47] Roberto Barontini & Lorenzo Caprio, *The Effect of Family Control on Firm Value and Performance, Evidence from Continental Europe* (ECGI – Finance Working Paper No. 88/2005) *available at* http://ssrn.com/abstract=675983. The sample consists of publicly listed companies with assets worth more than EUR 300 million as of the end of 1999 (Worldscope), Financial and regulated utilities are excluded, as are corporations where the controlling shareholder holds more than 95% of the share capital (i.e., companies only "nominally" public with little liquidity in stock).

the total of each country)	state	3.2%	9.7%	5.9%	7.7%	4.1%	14.5%	4.5%
	fin. institution	6.5%	11.1%	24.6%	7.7%	17.8%	13.8%	20.5%
	other entity	12.9%	2.8%	8.5%	7.7%	2.7%	11.6%	6.8%
	widely held corp.	12.9%	13.2%	12.7%	0.0%	39.7%	16.7%	25.0%

Types of controlling owners also differ among the EU member states, where in many countries families tend to be the prevalent type of controlling shareholder,[48] with institutional investors in a secondary position. It has been reported that in France, Germany and Italy, for example, close to or over 60 percent of listed firms have a family shareholder with stake of at least 20 percent.[49] State ownership is also a prominent feature in continental Europe. In the three countries mentioned above, the state held stakes of some 20 percent in between five and 10 percent of companies. The table below demonstrates the types of controlling shareholders in different EU member states.[50]

Selected data from Faccio & Lang (2003) on ultimate control of publicly traded corporations from a number of EU member states:

Country	Widely held	Family or unlisted firm	State	Widely held Corporation	Widely held Financial
Austria	11.11	52.8 6	15.32	0.00	8.59
Belgium	20.00	51.54	2.31	0.77	12.69
Finland	28.68	48.84	15.76	1.55	0.65
France	14.00	64.82	5.11	3.79	11.37
Germany	10.37	64.62	6.30	3.65	9.07
Ireland	62.32	24.63	1.45	2.17	4.35
Italy	12.98	59.61	10.34	2.88	12.26
Portugal	21.84	60.34	5.75	0.57	4.60
Spain	26.42	55.79	4.11	1.64	11.51
Sweden	39.18	46.94	4.90	0.00	2.86
UK	63.08	23.68	0.08	0.76	8.94

The data presents the percentage of firms by controlling shareholders with at least 20% stakes

[48] *Id*. at 2.
[49] *See* Faccio & Lang (2002), *supra* note 13.
[50] *Id*.

Control enhancing mechanisms

An important feature in many regions across the EU is the use of control structures that support the concentration of control in listed companies.[51] In these structures, control is generally separated by different means from cash-flow rights so that certain shareholders are able to retain a higher degree of control over a company than their relative share of equity ownership would suggest. The most common control mechanisms in use in the EU include pyramid structures, multiple share classes, shareholder agreements, as well as voting and ownership caps. [52]

In a pyramid shareholding structure, control in a target company is based on a chain of controlling ownership in intermediate companies. A shareholder can hold a controlling stake in one company that, in turn, holds a controlling stake in another company. The chain could include several companies – all in effect controlled by the same shareholder with a relatively small initial equity stake. In general, pyramid structures have been observed in markets with centralized ownership characterized by family controlled companies. Pyramid structures are more common in Asian countries, but they are also found in some EU countries, such as France.[53]

In a structure with multiple share classes, different voting rights are attached to different classes of shares. By retaining shares of a class with high voting rights, a controlling shareholder is able to retain control even if the company issues a large number of shares with low voting rights. In some cases both share classes are traded on the stock exchange, whereas in others the class with high voting rights remains unlisted. More often than not, the prices for different share classes do not differ markedly if both are listed. The use of multiple share classes with different voting rights is a central control mechanism in many EU member states. It is seldom a dominant feature among listed companies, but it still occurs in a number of publicly listed companies in many EU member states. For example, the structure is in use in Germany, Italy, Sweden and other Nordic countries.

In cross-shareholding structures, companies with the same ultimate controlling shareholder own shares in each other, entrenching the control position of the ultimate controlling shareholder. For example, cross-shareholdings have been widely used in Germany, where they were particularly prominent in the post war era in the largest German corporations. The structure was previously prominent in France in connection with privatisation initiatives in the 1980s. More recently, however, companies have been unwinding their cross-shareholdings, and they are no longer a central feature of large French companies.[54]

---

[51] Jeremy Grant & Thomas Kirchmaier: *Who Governs? Corporate Ownership and Control Structures in Europe*, (SSRN Working Paper, June 7, 2004), *available at* http://ssrn.com/abstract=555877.

[52] *See* EU Proprtionality Report (2007), *supra* note 13, at 25.

[53] *See* Stijn Claessens, Simeon Djankov, Joseph P.H. Fan, & Larry H.P. Lang, *The Benefits and Costs of Group Affiliation: The Evidence from East Asia* (CEPR Discussion paper 3364, 2002) *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=307426.

[54] *See* Antoin E. Murphy, *Corporate Ownership in France: The Importance of History* (NBER Working Paper Series 10716, 2004) available at http://www.nber.org/papers/w10716.pdf?new_window=1.

The following tables demonstrate the use of different types of control enhancing mechanisms in a number of EU member states and certain other jurisdictions [55].

Availability of Control Enhancing Mechanisms (by type of mechanism) as percentage of a pool of sample countries

CEM (by type of mechanism)	**Available**	**Availability unclear**
Multiple voting right shares	53%	-
Non-voting shares	42%	-
Non-voting preference shares	84%	-
Pyramid structures	100%	-
Priority shares	63%	5%
Depositary certificates	32%	11%
Voting right ceiling	58%	11%
Ownership ceiling	42%	16%
Supermajority provisions	89%	11%
Golden shares	42%	5%
Partnerships limited by shares	42%	5%
Cross-shareholdings	100%	-
Shareholder agreements	100%	-

The following table shows the overall frequency of different control enhancing mechanisms in a pool of sample countries, and demonstrates that pyramid structures and share-class structures are the most common mechanisms used.

Frequency of CEMs in Sample Countries

Pyramid structures	27%
Multiple voting right shares	24%
Shareholder agreements	12%

[55] EU Proportionality Report (2007), *supra* note 13, at 7, 15 and 25; surveyed states include Belgium, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, The Netherlands, Poland, Spain, Sweden, The United Kingdom, as well as non-EU states Australia, Japan and the United States.

Voting right ceiling	11%
Non-voting preference shares	9%
Ownership ceiling	6%
Cross-shareholdings	3%
Golden shares	3%
Priority shares	2%
Depositary certificates	1%
Non-voting shares (without preference)	1%

As the data suggest, different control enhancing mechanisms are largely available throughout the EU member states. It has been argued that control enhancing mechanisms emerge and develop in economies with a prevalence of concentrated ownership, as they support governance systems based on this structure of corporate ownership.[56] Where the controlling shareholder is cash-restrained and borrowing money is not a competitive option, the shareholder may be required to use equity financing. Under such circumstances a control enhancing mechanism is often employed to ensure that control over key business decisions is maintained. The variety of available mechanisms suggests that there are means to enhance control where this is desirable and that it can be very difficult to effectively prevent the use of such mechanisms through regulatory means alone. In fact, it can been argued that efforts to target these governance structures in connection with the adoption of the Takeover Directive have been counterproductive, as will be discussed in more detail below.

Concentrated Ownership and Firm Performance

An important question is whether ownership structure is related to firm performance. There has been concern that concentrated ownership may correlate negatively with firm performance, and an intuitive preference for promoting dispersed ownership and complementary governance models has been noted in international policy initiatives.[57] Several empirical studies have analyzed the correlation between firm performance and corporate ownership. The findings so far are inconclusive, but it seems that concentrated ownership as such does not imply inferior performance as such. While concentrated ownership does correlate with weaker firm performance in certain regions,[58] a number of studies have in fact found a positive correlation between firm performance and concentrated ownership,[59] while others have found a neutral effect.[60] With regard to the United States,

[56] *See* Bebchuk, Kraakman & Triantis (2000), *supra* note 14.
[57] *See* Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARVARD L. REV. 1641 (2006).
[58] See Claessens, S, Djankov, S., Fan, J.P.H. and Lang, L.H.P., *Disentangling the Incentive and Entrenchment Effects of Large Shareholdings*, 57 J. OF FIN. 2741 (2002).
[59] *See* Pedersen & Thomsen (2003), *supra* note 19 and Christian Weiss, *The Ownership Concentration of Firms: Three Essays on the Determinants and Effects* 133 (Dissertation, European Business School, International University Schloss Reichanthausen, 2010), *available at* http://hdl.handlenet/10419/30247.

studies have failed to demonstrate that companies with concentrated ownership have inferior performance to those with dispersed ownership;[61] instead, the evidence suggests that in the US concentrated ownership may even enhance corporate performance. Studies regarding companies in the EU member states report similar findings.[62] Empirical studies in the EU also find that there can be differences in firm performance depending on the type of controlling shareholder. A correspondence has been reported between companies with corporations or financial institutions as controlling shareholders and higher firm value. However, when controlling shareholders are families – especially second or third generation owners – the positive effect of ownership concentration on firm value is smaller.[63]

It has been suggested that a key element of performance in companies with concentrated ownership is the extent to which controlling shareholders extract private benefits of control. Achleitner, Betzer, Goergen and Hinterramskogler have studied European takeovers through private equity acquisition over a period of approximately 10 years.[64] Their research seeks to identify the effects of the ownership structure of target companies on acquisitions by private equity. The assumption is that the dynamics of private-equity-driven acquisitions will turn private equity buyers away from target companies where high levels of private benefits of control are extracted. The study makes several hypotheses and suggests, among others, that the probability of a firm being taken over by a private equity investor decreases when there is an active, monitoring shareholder.[65] The assumption is that a controlling shareholder will be incentivized to monitor management, resulting in better run companies and less potential value to be created by a takeover from private equity investors. The study finds evidence supporting this hypothesis,[66] and it makes a further hypothesis that companies with large shareholders who enjoy private benefits of control are less attractive to private equity investors.[67] The assumption is that the controlling shareholder will require a control premium to compensate for lost private benefits of control. Especially where such a premium must be shared by all shareholders, the costs of the acquisition would be too high. The study again finds support for this hypothesis.[68] However, importantly, it distinguishes between different types of controlling shareholders, finding that it is mainly the effect of family-owned companies in the data that supports the hypothesis.[69] After adjusting for family-owned companies, the study found no evidence of controlling shareholders extracting significant private benefits of control. The study notes that there is no theory on which types of shareholders are likely to monitor management and/or extract private benefits of control and hesitates to draw distinctions in this regard.[70] Nevertheless, the central finding is that not all controlling shareholders are equal with respect to their agendas.

The same point is reported by scholars finding a negative relationship between concentrated ownership and firm value. Cronqvist and Nilsson report on the effects of concentrated

---

[60] *See* Demsetz & Lehn (1985), *supra* note 19 and Harold Demsetz & Belen Villalonga, *Ownership Structure and Corporate Performance*, 7 J. OF CORP. FIN. 209, 210 (2001).
[61] *See* Demsetz & Villalonga (2001), *supra* note 60.
[62] *See* Pedersen & Thomsen (2003), *supra* note 19.
[63] *Id.*
[64] Achleitner, Betzer, Goergen & Hinterramskogler (2010), *supra* note 19.
[65] *Id.* at 6.
[66] *Id.* at 23.
[67] *Id.* at 7.
[68] *Id*. at 27.
[69] *Id.* at 27-30.
[70] *Id.* at 6.

ownership and control enhancing mechanisms on firm value in Sweden (measured by Tobin's q). They find a significant negative correlation between the level of "vote ownership" by controlling shareholders and firm value. They report that this correspondence is strong with respect to family-controlled companies, and they also find that families are more prone to using control enhancing mechanisms. However, Cronqvist and Nilsson suggest that the effect is not due to expropriation by controlling shareholders. Instead, they claim that the lower value of these companies is due to weaker returns on assets (ROA) from sub-optimal investment decisions. This, in turn, can be the result of a large, undiversified shareholder's lower appetite for risk and a preference for non-pecuniary private benefits of control. Interestingly, scholars reporting differing positive relationships between firm value and ownership concentration also emphasize the different agendas of controlling shareholders. Pedersen and Thomsen summarize that "[p]otential owners differ in terms of wealth constraints, competence, preference and non-ownership ties to the firm. This affects the way they exercise their ownership rights and therefore has important consequences for firm behavior and performance."[71] In other words, concentrated ownership, in itself, does not necessarily affect firm performance. Instead, what are relevant are the preferences of the controlling shareholder. The fact that the effect of concentrated ownership on firm performance and firm value varies depending on the type of controlling shareholder may demonstrate that control is not transferred when a particular controlling shareholder no longer provides efficient monitoring to maximize firm value, thus supporting the argument that shareholder entrenchment indeed occurs in EU companies with concentrated ownership.[72] If this were not the case, transfers of control should occur when a specific type of shareholder cannot maximize firm performance and value. This, again, suggests that transfer of control should be encouraged when a specific controlling shareholder no longer has a positive impact on firm performance.

B. The Development of the Structure of Corporate Ownership

Several reasons have been given for the prevalence of concentrated ownership in the EU. For instance, the relationship between ownership structure and the quality of corporate law has sometimes been emphasized in this context,[73] with concentrated ownership being associated with lower levels of investor protection in corporate law and consequent rent seeking by controlling shareholders.[74] Scholars have suggested that in an environment of low levels of investor protection, the initial owners of a company run the risk of losing control to other investors, who may then exploit the company, if they choose to raise public capital through the issuing of shares.[75] The use of control enhancing mechanisms can be similarly explained. In situations where an initial owner (an entrepreneur, for example) takes a company public, the owner may retain a controlling position in order to continue to monitor management. As

[71] Pedersen & Thomsen (2003), *supra* note 19, at 50.
[72] *See* Gilson (2006), *supra* note 57.
[73] La Porta et. al. (1999), *supra* note 5. The findings of the series of studies conducted by the authors have been subject to some criticism. It is unclear, for example, to what extent the indexes chosen in the study are valid proxies for investor protection in different jurisdictions. Moreover, the study measures formal compliance rather than whether the relevant rule is effectively applied, making comparisons between countries less relevant. *See also* Lucian A. Bebchuk, *A Rent-Protection Theory of Corporate Ownership and Control* (National Bureau of Economic Research Working Paper 7203, July 1999) *available at* http://www.nber.org/papers/w7203. The argument is made that in states with inadequate minority protection regulation, investors must seek to protect their investment by retaining the possibility to exercise direct control.
[74] La Porta et. al. (1999), *supra* note 5 and La Porta et. al. (2000), *supra* note 17.
[75] *See* Bebchuk (1999), *supra* note 73.

the company raises further capital, the owner may introduce instruments with cash flow rights but with little or no voting rights[76] to maintain this position. Typically, these mechanisms allow a controlling shareholder to exert disproportionate control in relation to his or her capital input. Such mechanisms have been seen to create incentives for controlling shareholders to pursue courses of action that are detrimental to other shareholders.[77] Bebchuk, Kraakman & Triantis[78] demonstrate that as the level of cash flow rights decreases in relation to control rights, the controlling shareholder may not be incentivized to pursue opportunities that maximize corporate wealth, instead choosing courses of action that serve his or her own purposes.[79] For example, controlling shareholders can engage all the company's assets in a venture while carrying only very limited financial risks themselves. This avenue of research suggests, among others, that developing corporate governance regulation and legal institutions will support a transformation towards dispersed ownership and facilitate the development of active capital markets.[80]

In the EU the assumption that concentrated ownership is linked to low levels of investor protection has nevertheless only proved partly true. Countries with undeveloped investor protection have certainly been found to have concentrated ownership but so too have other countries without this feature.[81] A number of studies report, for example, that concentrated ownership – and indeed control enhancing mechanisms – are prevalent not only in countries such as Italy and Portugal, where private benefits of control have been reportedly high,[82] but also in countries like Sweden, where they have been found to be low.[83] Moreover, as discussed above, it has been argued that agency problems typically related to concentrated ownership are accentuated when control enhancing mechanisms are in use. A number of studies support this assumption. It has been reported that family control and the use of control enhancing mechanisms in East Asia does have a negative impact on firm performance.[84] However, findings regarding the EU are not consistent in this regard, and there are indeed studies in the EU that find no relationship between self-dealing and concentrated ownership and control enhancing mechanisms.[85]

In fact, scholars have recognized that complex factors underlie the development of the structure of corporate ownership. We observe concentrated ownership in regimes with a low

---

[76] See Bebchuk, Kraakman & Triantis (2000), *supra* note 14.
[77] *Id.*
[78] *Id.*
[79] For example, with a limited investment the controlling shareholder can in fact engage all the company's assets in a venture, while carrying only very limited risk.
[80] *See* Bebchuk, Kraakman & Triantis (2000), *supra* note 14.
[81] *See* Gilson (2006), *supra* note 57.
[82] *See* LaPorta et. al. (1999), *supra* note 5.
[83] Several studies report low levels of private benefits of control by controlling shareholders in Sweden, for example. *See* Martin Holmén & Peter Högfeldt, 13 J. OF FIN. INTERMEDIATION 324 (2004), Martin Holmén & Peter Högfeldt, *Pyramidal Discounts, Tunneling or Overinvestment?*, 2 INT. REV. OF FIN. 133 (2009), Alexander Dyck & Luigi Zingales, *Private benefits of control: An international comparison*, 59 J. OF FIN. 537 (2004) and Agnblad, Berglöf, Högfeldt & Svancar (2001), *supra* note 21. The studies do not report a positive relationship between concentrated ownership and private benefits of control or a negative correlation between private benefits of control and the level of minority protection. *See also* Peter Högfeldt, *The History and Politics of Corporate Ownership in Sweden* in A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS 550 (Randall K. Morck, ed., 2005).
[84] *See* Faccio, M., Lang, Larry H.P. Lang & L. Young, *Dividends and Expropriation*, 91 AM. ECON. 54 (2001), and Claessens, Fan & Lang (2002), *supra* note 58.
[85] *See* Holmén and Högfeldt (2004), *supra* note 83.

level of investor protection and high private benefits of control[86] as well as in regimes with a supposedly high level of investor protection and low levels of private benefits of control. The question arises as to why concentrated ownership remains prevalent in the latter environment. In such circumstances a large shareholder incurs costs from being undiversified and possibly uses resources to monitor management in order to decrease managerial agency costs. Nevertheless, he or she is insufficiently compensated for this, as private benefits of control are unavailable.[87] A number of reasons have been given to explain this. Demsetz and Lehn argue that the structure of corporate ownership can be expected to vary in such a way that the structure in each case is consistent with value maximization.[88] Demsetz and Villalonga argue that the "ownership structure that emerges, whether concentrated or diffuse, ought to be influenced by the profit-maximizing interests of shareholders, so that, as a result, there should be no systematic relation between variations in ownership structure and variations in firm performance."[89] While Demsetz and Villalonga recognize that their argument is supported to differing degrees by the results of empirical studies, they believe they have sufficient empirical support for the view that "the market succeeds in bringing forth ownership structures…that are of approximate appropriateness for the firms they serve."[90]

However, markets and market participants are affected by their institutional environment. In fact, industrial development and political institutions[91] have a significant impact on the development of the structure of corporate ownership and corporate law. [92]In this context concentrated ownership has been seen to reflect the broader institutional environment. Roe mentions Germany, Italy and Sweden as examples of EU member states with a political and institutional environment that supports concentrated ownership.[93] Roe argues, for example, that in countries with strong labor institutions there is likely to be pressure for more corporate governance institutions that favor employees and less for institutions that support the interests of shareholders.[94] For example, companies are likely to be encouraged to expand to secure employment even at the cost of profitability and to avoid down-sizing and taking disruptive risks.[95] In this environment the institutions needed for dispersed ownership to flourish are not present, whereas a controlling shareholder, on the other hand, would be in a relatively better position to bargain over surplus and to resist political pressures.[96] Other political economy explanations point out that in states with concentrated ownership a political majority with fewer financial incentives (and more labor-oriented financial interests) may oppose a market based system related to higher risk taking.[97] In this environment the political system can be expected to favor large shareholders and labor at the cost of smaller investors and to support complementary governance structures – much of which can be observed in EU member states

---

[86] *See* La Porta et. al. (1999), *supra* note 5.
[87] *See* Gilson, *supra* note 57, at 1649-1650.
[88] *See* Demstez & Lehn (1985), *supra* note 19.
[89] Demsetz & Villalonga (2001), *supra* note 60, at 210.
[90] *Id.* at 231.
[91] *See* Mark J. Roe, *Political Preconditions to Separating Ownership from Corporate Control*, 53 STAN. L. REV. 539 (2000) and MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE (2003).
[92] See Lucian A. Bebchuk and Mark J. Roe, *A Theory of Path Dependence in Corporate Governance and Ownership*, 52 STAN. L. REV. 127 (1999).
[93] *See* Roe (2004), *supra* note 42.
[94] *Id.* at 18.
[95] *Id.* at 18-19.
[96] *Id.* at 19.
[97] *See* Enrico C. Perotti & Ernst-Ludwig von Thadden, *The Political Economy of Dominant Investors* (Tinbergen Institute Discussion Paper 2004-091/2), *available at* http://dare.uva.nl/document/5462.

with concentrated ownership. The effect of incumbent industrial and financial interest groups' interest to restrain competition on the development of financial systems has also been emphasized.[98] Rajan and Zingales argue that it is in the incumbents' interest to restrict financial development and the openness of the economy in order to prevent the emergence of competitors. Nevertheless, as a result of globalization, their impact on financial markets has decreased, resulting in an increase in financial development and market-based corporate governance institutions.[99]

C. THE REGULATORY IMPLICATIONS OF OWNERSHIP STRUCTURE

The structure of ownership has important implications for corporate governance regulation. A key factor in this regard is how complementary institutions develop to facilitate corporate structures. Roe identifies several relevant institutions in the United States with respect to corporate governance, including markets (product markets, capital markets and managerial labor markets), the board of directors, information distribution and gate-keeping, mechanisms for coalescing shareholders, executive compensation, professionalism and norms, corporate lawsuits, capital structure and bankruptcy.[100] In different ways and with different effects, they each address various aspects of corporate governance. The institutional environment of business enterprises and corporate governance is complex, with regulation being just one relevant factor. The introduction of regulatory changes may have unintended consequences, as complementary institutions have evolved to reflect existing regulation. It is possible that regulatory changes that are not adapted to the broader institutional environment lead to inefficient outcomes. For example, there may be a lack of relevant institutions that support the intended effects of the change. For regulatory goals to be achieved, many relevant factors in the institutional environment would need to be simultaneously changed. However, these factors can be difficult to identify. The structure of corporate ownership will have an effect on the type of institutions that are developed to coordinate the interests of corporate constituencies.[101] Active takeover markets are typically associated with dispersed ownership, and thus the pressure is towards the establishment and development of regulatory systems that facilitate these markets. In the context of concentrated ownership, other coordination mechanisms may develop instead, with different regulatory implications.

The structure of corporate ownership is reflected in how corporations are controlled. Maintaining corporate control is a key factor in the governance of both dispersed and concentrated ownership. In governance models reflecting dispersed ownership, control over the use of corporate assets is mainly in the hands of the board of directors, whereas in the context of concentrated ownership, the controlling shareholders often have de facto control over the corporation and its business.[102] Legal institutions have developed that complement these systems. Control enhancing mechanisms can, in fact, be seen as a complementary mechanism that can be used to leverage the monitoring function of controlling shareholders – in the absence of alternative governance institutions. In this way, controlling shareholders can

---

[98] *See* Raghuram G. Rajan & Luigi Zingales, *The Great Reversals: The Politics of Financial Development in the Twentieth Century*, 69 J. OF FIN. ECON. 5 (2003).
[99] *Id.*
[100] *See* Roe (2004), *supra* note 42.
[101] See Bebchuk & Roe (1999), *supra* note 92, at 138-140.
[102] Marco Becht, Patrick Bolton & Ailsa Röell, *Corporate Governance and Control* 46 (ECGI Finance Working Paper No 02/2002, updated August 2005), *available at* http://ssrn.com/abstract=343461.

obtain economies of scale and decrease firm specific risk.[103] Nevertheless, the opposing view must also be recognised, according to which the differentiation of cash flow and voting rights increases the potential for the majority shareholder to pursue his or her own personal benefit. The premise, then, that control enhancing mechanisms can serve a legitimate governance purpose is based on the application of effective limits on the extraction of private benefits of control.[104]

These differences have been reflected in the allocation of legal powers between corporate constituencies, which in turn has affected the evolution of ownership structures. This analysis has interesting implications for the importance of retaining corporate control. Cools has studied the differences between the allocation of legal powers in Delaware, representing a system with institutions oriented to dispersed ownership, and in certain EU member states with concentrated ownership.[105] She observes that under Delaware law the allocation of legal powers favors directors and in fact grants limited opportunities to shareholders to affect corporate matters. She argues that as a consequence, when original controllers in Delaware companies raise further equity financing, they need not retain a majority of shares to maintain corporate control as long as they have ensured they are appropriately represented on the board of directors. Moreover, although outside investors are able to buy larger stakes in the company, doing so would bring little benefit considering the limited power that even a significant stake provides in Delaware corporations.[106] On the other hand, in models where the allocation of legal powers favors shareholders, as according to Cools is the case in many EU Member states, the "original controllers" must ensure they have sufficient voting rights by maintaining a sufficient majority of shareholdings or by making use of control enhancing mechanisms.[107] An important point is that in either case control remains entrenched. While in the United States the institutional structure results in "strong managers and weak owners,"[108] the institutional set up in a number of EU jurisdictions may provide for the opposite. Institutional development, then, plays an important role in explaining the structure of corporate ownership.

An important aspect of the interaction between ownership structure and the institutional environment is path dependence. The institutional environment affects the initial choices of corporate ownership structure, which tend to be path dependent, explaining why different structures of corporate ownership and different corporate governance systems persist. Once a given structure has been established, it is likely to be reinforced as complementary institutions develop.[109] As discussed by Bebchuk & Roe,[110] sunk costs, externalities and complementarities caused by initial choices of ownership structure increase the cost of choosing alternative structures. Existing structures may also persist due to rent-seeking by

---

[103] Ronald J. Gilson & Alan Schwartz, *Constraints on Private Benefits of Control: Ex Ante Control Mechanisms versus Ex Post Transaction Review* 4 (ECGI Law Working Paper 194, 2012), *available at* http://ssrn.com/abstract=2129502

[104] *See* Bebchuk, Kraakman & Triantis (2002), *supra* note 14.

[105] Sofie Cools, *The Real Difference in Corporate Law between the United States and Continental Europe: Distribution of Powers* 64 (Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series, Paper 490, 2004) *available at* http://lsr.nellco.org/harvard_olin/490.

[106] As a significant portion of the largest US corporations are domiciled in Delaware, the laws of this jurisdiction are used to represent the prevalent position in the United States.

[107] Cools (2004) *supra* note 105, at 64.

[108] *See* MARK J. ROE, STRONG MANAGERS, WEAK OWNERS, THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1996).

[109] *See* DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE (1990).

[110] *See* Bebchuk & Roe (1999), *supra* note 92.

parties empowered by the initial structure. The regulatory framework can be seen as a complementary institution that recognizes and reinforces certain ownership structures due to both efficiency and rent-seeking. It is important to recognize the self-reinforcing nature of the structure of corporate ownership, and its relationship to the applicable regulatory framework, in any initiatives to develop corporate governance regulation – in particular with regard to supranational initiatives to be applied across jurisdictions with different structures of corporate ownership.

Empirical research supports the claim that the structure of ownership tends to persist over time. Grant and Kirchmaier compare ownership structures in the largest companies of a number of EU member states with long term share price trends to determine whether companies with superior performance also represent the dominant structure of ownership. Controlling for industry, country effects, liquidity and type of controlling owners,[111] they find that ownership structures do not seem to be consistent with value maximization principles.[112] In other words, even if companies with a *de facto* controlling shareholder might represent superior performance, that might not be the dominant structure of corporate ownership in a particular country. Thus, the structure of corporate ownership does not evolve towards the most efficient model in a given economic system or jurisdiction, as suggested by Demsetz & Lehn. Instead, Grant & Kirchmaier suggest that "current European ownership structures are a function of the complex interaction of historic national regulation, tax codes, strength of institutional investors and individual/family wealth preferences, constraints and psychology. The balancing of these interests through the political process at country level has been a prime determinant of current corporate structures." One reason Grant & Kirchmaier give for why ownership structures persist is that parties (the dominant shareholder, for example) are not compensated for losing previously available private benefits. Controlling shareholders might even face negative consequences for divesting. Moreover, where benefits are non-pecuniary, compensation might be hard to realize.[113] The authors conclude that creating incentives for changing the structure of corporate ownership might, in fact, be as important as trying to address concerns related to currently dominant structures of corporate ownership through regulation.[114]

Entrenchment of corporate control is not a feature restricted to controlling shareholders. In fact, Pacces suggests that the entrenchment of corporate control may be not just a distortion of separation of ownership and control…but rather one of its distinctive features.[115] The entrenchment of control has been widely debated in relation to dispersed ownership systems such as that of the United States. It has been argued that the corporate governance monitoring mechanisms believed to operate in dispersed ownership systems may not be as effective as assumed. For example, the central role of the board of directors has long been emphasized in the United States, and it has been argued that instead of shareholder primacy, companies with dispersed ownership are in fact controlled by the boards – albeit in the interest of the shareholders.[116] More recently it has been argued, however, that the monitoring mechanisms assumed to police the board and management fail to function effectively. For example, hostile

---

[111] Grant & Kirchmaier (2004), *supra* note 51.
[112] *Id.* at 4.
[113] *Id.* at 19.
[114] *Id.* at 20.
[115] ALESSIO M. PACCES, RETHINKING CORPORATE GOVERNANCE – THE LAW AND ECONOMICS OF CONTROL POWERS 14, 411-413 (2012).
[116] *See* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547 (2002-2003).

takeovers no longer seem to provide the management monitoring function they were once believed to perform.[117] With the development of corporate law and practice, anti-takeover mechanisms have become sufficiently permissible to make the hostile takeover less relevant. The extensive case law related to takeover defenses in the Delaware courts suggests that the most stringent board requirements only apply when it has become clear that the company has come up for sale or break up. [118] Until that stage, the board has been deemed to have broad discretion to prevent takeover initiatives from proceeding. Researchers and regulators have also voiced concern that shareholders are in fact relatively powerless in the United States.[119] Boards of directors enjoy a considerable degree of independence in corporate decision-making and seldom have to refer matters to shareholders, [120] and in matters where shareholders are allowed a voice, directors have been given a right of veto.[121] By way of comparison, boards in EU member states generally require the consent of shareholders if they wish to issue new shares (sometimes a simple majority for pre-emptive offerings and a qualified majority for directed offerings) or pay dividends. In a number of EU member states, shareholders have more powers that can be effectively enforced at shareholder meetings,[122] and a controlling shareholder can wield considerable power at the meeting based on his holdings. In this way, control is entrenched with controlling shareholders in the EU, while in the United States it is entrenched with directors.

The above findings suggest that the entrenchment of control is pervasive, and that addressing this issue through regulatory intervention might be challenging regardless of the structure of ownership. The findings also suggest that it remains important to seek to facilitate the transfer of control and to develop the regulation of control transactions. The EU may well have a legitimate role in this process, as national governance systems have shown signs of further consolidating existing control structures.

D. CONCLUSIONS: PREREQUISITES FOR REGULATORY DEVELOPMENT

Above, the study has described the structure of corporate ownership and the prevalence of concentrated ownership in EU member states. Importantly, the study provides evidence that neither concentrated ownership nor even control enhancing mechanisms as such are necessarily detrimental to firm performance. More important are the preferences and courses of action pursued by those controlling the company. For the purposes of this study, the implications of these findings are that it may be advantageous to seek to effect a transfer of control by appropriate means when the current ownership situation is no longer efficient, rather than design regulation that challenges existing structures of ownership or control. The question is what legal strategies are suitable for such purposes in each particular institutional environment and in light of the relevant regulatory processes. Theoretical explanations provided in the legal and political economy literature for the development of the structure of corporate ownership have been discussed in brief. While these different explanations have

---

[117] *See* Lucian A. Bebchuk & Allen Ferrell, *A New Approach to Takeover Law and Regulatory Competition* (NBER Working Paper No. w8148, 2001), *available at* http://ssrn.com/abstract=262103.
[118] Revlon Inc. v. Macanderws and Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Paramount Communications, Inc. v. Time, Inc., 571 A 2d 1140 (Del 1989).
[119] Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV.L.REV. 833 (2005) and Lucian A. Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS.LAW. 43 (2003).
[120] DGCL §170, *See* Cools (2004), *supra* note 104, at 46-47.
[121] DGCL § 242 (b)(1); for example, under Delaware law proposals for charter amendments can only be made by a proposal of the board at a shareholder meeting.
[122] For a discussion on Belgium and France, *see* Cools, *supra* note 105.

been subject to criticism, and some may even contradict each other, they do emphasize the fact that the structure of corporate ownership is affected by, and interacts with, the relevant institutional environment. It is no great feat to conclude that legal, economic and political institutions affect how companies are owned and governed. However, it is further argued that these institutions are persistent and only change slowly over time. The persistence of governance arrangements – and the entrenchment of dominant corporate constituencies – is a major consideration when planning regulatory intervention. For the purposes of this study, the relevant question is how this interaction should be reflected in the design of EU-level corporate governance regulation.[123]

The study now turns to a discussion of corporate governance in the context of concentrated ownership, with the aim of identifying key regulatory concerns. After that, there follows a discussion of the EU-level regulatory responses to these concerns (and to concentrated ownership in general), and an assessment of the legal strategies chosen by the EU Commission for addressing issues related to concentrated ownership. The study will then provide alternative strategies or regulatory designs and assess the EU-level response to developing EU takeover regulation.

III. CONCENTRATED OWNERSHIP AND CORPORATE GOVERNANCE

This section first discusses corporate governance issues that arise in companies with concentrated ownership. The study then turns to the effects of concentrated ownership on the dynamic of change of control transactions.

A. CORPORATE GOVERNANCE RELATIONSHIPS AND CONCENTRATED OWNERSHIP

In corporate governance literature, agency problems have been seen to arise whenever a representative or agent acts for the benefit of another party.[124] For instance, the agent may primarily seek to act in his own interests rather than in the best interests of the principal.[125] Typically, in situations where such problems arise, the agent may be better informed about the circumstances affecting his or her interests and those of the principal, and monitoring the agent's actions may be difficult. Attempts are typically made to create structures which align the interests of the agent with those of the principal. The main agency relationships typically identified in the context of corporate governance are the relationship between management and shareholders, the relationship between controlling shareholders and other shareholders and the relationship between shareholders and employees, creditors or other third party stakeholders in the corporation.[126]

In companies with concentrated ownership, the key agency problem is the risk of a controlling shareholder seeking to use his or her controlling position in the company to extract private benefits of control that are not available to other shareholders. This can happen where a shareholder is able to execute transactions with a target company under terms and conditions that benefit the shareholder. This diversion of corporate assets and opportunities has been

---

[123] *See* Gerard Hertig & Joseph McCahery, Joseph A., *Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition?* (ECGI Law Working Paper No. 12/2003), *available at* http://ssrn.com/abstract=438431.

[124] *See* Michael Jensen & William Meckling, *Theory of the Firm - Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. OF FIN. ECON. 305 (1976).

[125] *Id.*

[126] Armour, Hansmann & Kraakman (2009), *supra* note 10, at 35-37.

labelled "diversionary private benefits of control"[127] or simply "stealing."[128] Agency problems also occur when a controlling shareholder uses his or her controlling position to have the corporation pursue goals that are not aligned with the interests of the other shareholders (pursuing the personal agendas of the controlling shareholders rather than value maximizing, for example). A comparable situation is when a controlling shareholder fails to use his or her controlling position to monitor management but still retains that controlling position. These situations have been labelled "distortionary private benefits of control" [129] or simply "shirking."[130]

If a controlling shareholder only retains limited private benefits of control while providing an efficient monitoring service for the other shareholders, the agency costs may be comparable to a system with dispersed shareholdings, or even lower.[131] Indeed, it has been recognized that concentrated ownership can provide an efficient mechanism for monitoring management. A large, undiversified controlling shareholder may be able to provide more effective monitoring of management than the market-based mechanisms available in a dispersed ownership environment.[132] Ultimately, investments in a company with concentrated ownership can be expected to be based on a trade-off between the costs associated with the possibility of extraction of private benefits of control by the controlling shareholder and the benefit of the monitoring performed by an undiversified and consequently incentivized shareholder.[133] Based on this trade-off, there may well be situations where concentrated ownership is an efficient ownership structure from the outset.[134] It has been recognized that even allowing some private benefits of control to be extracted by a controlling shareholder as compensation for an undiversified position and for performing the monitoring function can be in the interests of other shareholders.[135] Controlling shareholders carry costs related to concentrated ownership, such as liquidity and non-diversification costs,[136] as well as costs related to performing the monitoring function. The controlling shareholder may require at least some compensation for these costs in the form of private benefits of control, without this actually being detrimental to the other shareholders compared to other structures of corporate ownership.[137]

Gilson & Gordon raise an important point with regard to private benefits of control and controlling shareholders.[138] They identify three alternative ways in which such benefits may be extracted. A controlling shareholder may take a disproportionate share of the company's

---

[127] Alessio M. Pacces, *Control Matters: Law and Economics of Private Benefits of Control* 14 (Rotterdam Institute of Law and Economics, Working Paper 2009/04, 2009), *available at* http://ssrn.com/abstract=1448164.
[128] Mark J. Roe, *Corporate Law's Limits* 16-17 (Columbia Law School Center for Law and Economic Studies, Working Paper 186, 2002), *available at* http://papers.ssrn.com/abstract=260582.
[129] Pacces, *supra* note 127, at 14.
[130] Roe (2002), *supra* note 128.
[131] Gilson (2006), *supra* note 57, at 1650-1652.
[132] *See* Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785 (2003).
[133] Typically, the controlling shareholder is not burdened by the free-rider problem affecting diversified shareholders; it is not e in the interests of a shareholder to perform monitoring and incur the full costs of this while the benefits are shared by all shareholders alike.
[134] *See* Gilson (2006), *supra* note 57; *but see also* Mike Burkart, Denis Gromb & Fausto Panunzi, *Large Shareholders, Monitoring and the Value of the Firm*, 112 Q'LY J. OF ECON. 693 (1997).
[135] See Bebchuk & Roe (1999), *supra* note 92; and Gilson & Gordon (2003) *supra* note 132, at 786.
[136] Gilson (2006), *supra* note 57, at 1652.
[137] *Id.*
[138] *See* Gilson & Gordon (2003), *supra* note 132.

current earnings, freeze out the minority or sell his or her controlling block at a premium. Gilson & Gordon point out that these methods of extraction are substitutes and must be addressed with symmetric responses. It seems futile to seek to limit extraction of control premiums in takeovers if controlling shareholders have the opportunity to extract private benefits of control through related-party transactions – and vice versa. In fact, Gilson & Gordon argue that on balance regulation favouring the sale of control may create the potential for greater efficiency gains than regulation favouring freeze outs. To the extent that there are effective limits on the extraction of private benefits of control from ongoing operations, an acquirer of a controlling block will have to increase efficiency to obtain benefits from the transaction – which then come to benefit the minority shareholders as well.[139] This suggests, among others, that takeovers and the transfer of control cannot be analysed or regulated in isolation from other aspects of corporate governance. To develop takeover regulation and a market for corporate control it is important to ensure that other situations where private benefits of control could be extracted are also properly regulated, as will be argued below.

B. THE IMPLICATIONS OF CONCENTRATED OWNERSHIP FOR THE REGULATION OF CHANGE OF CONTROL

The exercise and transfer of corporate control lie at the heart of corporate governance. In change of control situations, the potential for conflicts of interest among corporate stakeholders may be particularly accentuated. Managers may seek to avoid change of control, as they could well be replaced as a result, while shareholders may wish to sell their shares at a premium. A controlling shareholder may have interests that are different from the other shareholders and may seek to freeze out the minority or obtain a premium not offered to other shareholders for the controlling stake.[140] The controlling shareholder may also retain control even when no longer performing an effective management function. Moreover, if the controlling shareholder can extract private benefits of control, it may not be in a controlling shareholder's interest to relinquish control unless future potential private benefits are compensated for, which creates a disincentive for controlling shareholders to agree to some value-increasing takeovers.[141] These problems are further accentuated when control enhancing mechanisms are used to separate cash flow and voting rights.

The dynamic of takeovers and the effects of takeover regulation differ significantly depending on the structure of corporate ownership. In companies with dispersed ownership, takeover regulation is typically intended to address the relationship between management and shareholders. Takeovers, or the possibility thereof, can be seen to perform a management monitoring function. In companies with concentrated ownership, the controlling shareholder will often hold, in effect, the key to control of the company, and takeovers as such do not perform the same governance function as in companies with dispersed ownership. In fact, concentrated ownership has been seen as an alternative monitoring mechanism to takeovers to restrain management.[142] The dynamic of takeovers is consequently quite different in an environment of concentrated ownership. Takeover regulation may be of significant importance, however, in protecting minority shareholders from the possible self-interested behaviour of the controlling shareholder. In this context, regulation could be expected to address the possibility of controlling shareholders extracting private benefits of control in the

[139] *Id.* at 21-22.
[140] Paul Davies & Klaus Hopt, *Control Transactions*, in Kraakman et. al (2009*), supra* note 10, at 257.
[141] *See* Lucian A. Bebchuk, *Efficient and Inefficient Sales of Corporate Control*, 109 Q. J. of Econ., 957, (1994).
[142] *See* Becht, Bolton & Röell (2002), *supra* note 102, at 1.

form of unwarranted control premiums, or it would seek to compensate minority shareholders for unfair terms. Regulation could also address the possibility of a controlling shareholder deciding not to transfer control even when he or she no longer performs an effective monitoring function. Developing adequate regulatory responses to these issues is complex, as will be discussed in more detail below.

One of the key questions for regulating control transactions (or the sale of control blocks) in the context of concentrated ownership is whether the opportunity to sell is also extended to other shareholders and if so, what the sale price should be. Two regulatory models have generally been distinguished in this regard: the "market rule" and the "equal opportunity rule."[143] Pursuant to the market rule, a controlling shareholder is free to sell his shares without the opportunity having to be extended to other shareholders. In the United States, Delaware corporate law generally allows for such sales, with certain limitations.[144] The application of the rule is predicated on the controlling shareholders not being able to extract significant private benefits of control in related-party transactions.[145] Gilson & Gordon explain that with this precondition (private benefits capped by legal rules), minority shareholders will also benefit from the transaction, as long as the premium extends only to the net present value of private benefits of control from operating the company, because a "buyer would not wish to acquire the controlled corporation at a price that reflects the capitalized value of private benefits unless it thought it could increase the value of its purchased interest."[146] Consequently, assuming that the extraction of private benefits of control is restricted, the market rule should be unproblematic from an investor protection perspective.

The equal opportunity rule provides that in a change of control situation, all shareholders are given the opportunity to sell their shares on the same terms. The equal opportunity rule can be implemented through a mandatory bid obligation,[147] whereby the acquirer of the controlling block is obliged to extend the offer to all other shareholders on the same terms. The reasons given for such a rule have been based on fairness-related arguments. The rule also serves to prevent value-decreasing transactions from occurring, as the premium payable must cover the capitalized value of the future private benefits of the original holder of the controlling block for the holder to agree to the transaction. However, this also raises the issue of value-increasing transactions becoming unfeasible,,[148] unless the level of premium obtained by the original holder of the controlling block exceeds the capitalized value of future private benefits of control (note that the same premium shall be offered to all other shareholders as well).[149] If the controlling shareholder cannot be paid a control premium, the shareholder may not be prepared to sell, preferring instead to continue extracting private benefits of control where available, which leads to inefficiency.[150] This increases the cost of change of control

143 *See* Bebchuk (1994), *supra* note 141.
144 In re Sea-Land Corp. Shareholders Litigation, 1987 WL 11283, 5 (Del.Ch.1987); Harris v. Carter, 582 A.2d. 222, 235 (Del.Ch. 1990).
145 *See* Bebchuk (1994), *supra* note 141 and Gilson & Gordon (2003), *supra* note 132; see also TIMO KAISANLAHTI: SIDOSRYHMÄT JA RISKI PÖRSSIYHTIÖSSÄ [Interest Groups and Risk in a Listed Company] 71-72 (1998).
146 *See* Gilson & Gordon (2003), *supra* note 132.
147 Mike Burkart & F. Panunzi, *Mandatory Bids, Squeeze-out, Sell-out and the Dynamics of the Takeover Process* (ECGI Law Working paper No. 10/2003) *available at* http://my.liuc.it/MatSup/2007/F93111/takeoverregulation.pdf.
148 Bebchuk (1994), *supra* note 141, at 971-972.
149 Berglöf & Burkart (2003), *supra* note 18, at 196-198.
150 Goergen, Martynova & Renneboog (2005), *supra* note 31, at 11.

transactions and consequently may discourage bidders from making bids that would be value-increasing. The mandatory bid rule also has negative implications for corporate restructuring, as it can reduce trade in control positions. Berglöf & Burkart conclude that the mandatory bid rule "may or may not be good for minority protection: the rule increases the compensation to minority shareholders in case of a successful takeover, but it decreases the likelihood of a takeover. Which effect dominates is an empirical issue."[151]

In jurisdictions where private benefits of control are low, it does not seem necessary to apply a strict equal opportunity rule for the purposes of avoiding the abuse of the minority. However, modified exit rights might still be contemplated in the case of transfers of control leading to considerable changes in corporate strategy or corporate structure, and they could be equated with transactions requiring corporate decisions with a minority veto right. Nevertheless, in these circumstances there may be more room to adjust exit rights to meet the policy goal of facilitating control transfers. In other words, as long as there is robust corporate governance regulation to limit the extraction of private benefits of control from current earnings through related party transactions, there may be room for flexibility when setting detailed minority exit rights in connection with takeovers.

The next section will provide an overview of how these issues can be addressed through different legal strategies. The study then turns to what legal strategies have been used in EU corporate governance regulation, and in the Takeover Directive in particular, to address concerns over concentrated ownership. The study then considers alternative regulatory approaches in the light of the regulatory challenges described above.

IV. LEGAL STRATEGIES FOR EU CORPORATE GOVERNANCE REGULATION

Legal intervention in the markets and economic activity can take many forms, varying from the enforcement of set standards of behaviour (such as the fiduciary duties of the board) to empowering economic actors to pursue their rights independently through legal and contractual structures (shareholders' meetings, for example). To be effective, the type of legal intervention may need to be adjusted to the particular circumstances. For example, intervention cannot rely on aggrieved parties pursuing their rights independently if they lack the incentive or means to do so. Legal intervention might also be too detailed or too rigidly defined to respond to changes in the activity that was intended to be regulated. Another factor to consider in planning legal intervention and designing regulations is how they will be received by the affected constituencies and whether it is likely that the initiatives will successfully pass into law.

Below, I discuss legal strategies for corporate governance regulation, the factors affecting the choice of legal strategies for supranational (EU) legal intervention, as well as the political aspects of the choice of legal strategy.

A. LEGAL STRATEGIES FOR CORPORATE GOVERNANCE REGULATION

Several factors must be taken into account when considering the appropriate regulatory responses to policy concerns. Naturally, a basic question is whether a regulatory response is required at all, or whether the matter should be left to market mechanisms. The regulatory concerns that arise in the context of corporate governance can be addressed by different substantive legal mechanisms according to the nature of the agency situation (shareholders

[151] Berglöf & Burkart (2003), *supra* note 18, at 175.

and the board of directors, minority and majority shareholders) and the characteristics of the relevant institutional environment (such as the effectiveness of the court system or the structure of corporate ownership). Kraakman et al. have drawn up a typology of legal strategies with respect to principal-agent problems in the context of corporate governance. In this typology, legal strategies are divided into regulatory strategies and governance strategies, where regulatory strategies are prescriptive and provide substantive terms for the principal-agent relationship and governance strategies provide different mechanisms for the principal to control the agent's behavior.[152]

Regulatory strategies that may be used to constrain the activities of the agent include rules (ex ante) and standards (ex post). Many corporate governance matters may require more complex assessments that cannot be readily provided for through specific rules and are instead better suited to ex post assessments of propriety (standards such as the fiduciary duties of management, for example). Further regulatory strategies identified by Kraakman et al. include the terms of entry and exit for principals.[153] Terms of entry include disclosure obligations for agents (managers) regarding the provision of information to outside investors prior to their becoming shareholders. Exit terms include appraisal rights and the transferability of shares.

Governance strategies include appointment rights, i.e., the right to select and remove agents. Selection rights apply both to the agency relationship between shareholders and managers and the relationship between majority and minority shareholders (i.e., granting board selection rights to minority holders as well).[154] Other governance rights include decision rights and agent incentives. Decision rights can take the form of the right to initiate or ratify management decisions, i.e., which corporate decisions are subject to shareholder approval. For example, significant differences can be identified in this regard between jurisdictions with a tradition of concentrated ownership and others with dispersed ownership.[155] Agent incentives are generally based on mechanisms whereby agents are rewarded on the basis of their performance. Legal rules may provide frameworks for relevant management compensation schemes in this regard. With respect to the relationship between majority and minority shareholders, loyalty is based on a sharing rule whereby the agent's returns are tied to those of the principal (the principle of equal treatment, for example).

Kraakman et al. consider how the choice of legal strategies differs across jurisdictions depending on, among others, the prevalent structure of corporate ownership and the quality of enforcement. The authors suggest that the choice of legal strategies is likely to complement key characteristics of the relevant institutional environment. For example, the authors hypothesize that governance strategies are likely to evolve in jurisdictions where corporate ownership is concentrated, with a smaller group of owners benefiting from lower coordination costs. In contrast, where ownership is diffuse, there is more need for regulatory strategies.[156] Their analysis resembles the established view on the impact of interest groups on regulation developed by Mancur Olson.[157] To the extent that a small, homogenous group has similar interests, they are likely to be able to coordinate their efforts to affect political and regulatory

[152] Armour, Hansmann & Kraakman in Kraakman et.al. (2009), *supra* note 10, at 39.
[153] *Id.*, referred to as "Affiliation Terms".
[154] Armour, Hansmann & Kraakman in Kraakman et.al. (2009), *supra* note 10, at 42.
[155] *See* Cools (2004), *supra* note 105.
[156] Armour, Hansmann & Kraakman in Kraakman et.al. (2009), *supra* note 10, at 52.
[157] *See* MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS (prtg. 1971).

outcomes. On the other hand, heterogeneous groups with similar interests have considerable coordination problems, and may need protection by regulatory intervention.

Applied to corporate governance regulation in an environment with concentrated ownership, the above would suggest that controlling shareholders should be able to pursue their interests independently. Consequently, governance strategies are likely to be used with respect to the agency relationship between shareholders and managers. It is probable, for example, that the right to appoint and remove directors can be used effectively in an environment with large shareholders. Minority shareholders, however, lack a similar ability to defend their interests, and with respect to the relationship between controlling shareholders and minority shareholders, regulatory strategies are likely to be observed. Thus, standards for director behavior are important in such a context. Standards may also be needed to protect minority shareholders from potential abuse by controlling shareholders. Entry and exit rights are also important for minority shareholders and are reflected in such things as mandatory bid rules. Similarly, large shareholders might be able to enforce their rights through private means, whereas minority shareholders would need to rely on public enforcement. An interesting question is whether some governance strategies might also be suitable for regulating the relationship between controlling shareholders and minority shareholders. For example, instead of to attempting to provide mechanisms that challenge the control of large shareholders, regulation might seek to incentivize controlling shareholders to transfer control when a change of ownership structure is called for.

B. Factors Affecting EU-Level Supranational Legal Strategies

Which legal strategies might thus be expected to be applied in the EU context? As was mentioned earlier, the adoption of supranational regulation poses challenges in cases where the relevant institutional environment differs across affected jurisdictions – a case in point being the EU-level regulation of takeovers in an environment where the structure of ownership differs considerably from member state to member state. Moreover, the introduction of EU regulation has created a multi-tier framework of both national and supranational regulation, providing different avenues for interested constituencies to affect regulatory initiatives. As EU-level regulation in many respects relies on national enforcement mechanisms, there is also a risk that regulation will be both interpreted and enforced in different ways across the EU. These characteristics, among others, need to be taken into account when choosing EU-level legal strategies. Below, I discuss some of the characteristics of a supranational environment in the context of regulatory initiatives – i.e., what factors should be considered when contemplating supranational regulatory intervention and choosing appropriate legal strategies. As will be demonstrated, these factors add to the complexity of designing regulation, and even to the typology of regulatory mechanisms.

Harmonization or Competition

A key question in considering the preconditions for regulatory intervention is whether the matter at hand requires an EU-level regulatory response or whether the appropriate avenue is negative harmonization through the courts and leaving the matter for regulation at the national level. With respect to corporate governance regulation, such an assessment is linked to the harmonization-competition debate. The assumption underlying positive harmonization is that "(c)entralized regulation, or positive integration, furthers market integration by establishing a framework of common rules in all Member States"[158]. However, supranational regulatory intervention is not always needed to promote integration. The national courts or the ECJ can also intervene in national measures that contravene basic freedoms in the EU treaties. The choice of appropriate rules is left to member states, but they must still be compatible with treaty freedoms, including the freedom of establishment. In the context of corporate law, the *Centros* case[159] and several subsequent landmark cases on the freedom of establishment have slowly paved the way for regulatory competition within the EU. The underlying assumption is that companies and business will seek to migrate to jurisdictions that offer the best regulatory environment within the EU, which will lead to regulatory competition and to the development and adoption of competitive solutions with respect to national corporate governance regulation. However, considerable national lock-ins remain, as companies are subject to a plethora of regulation, varying from labor regulation to taxation. Moreover, while the benefits of harmonization are certainly open to debate, some criticism of EU harmonization of corporate law is also self-serving, originating from interested constituencies who have been able to dominate domestic regulatory policy but find the EU-level political dynamic more challenging in this regard.[160] Regulatory competition in the EU is still far from effective and cannot be relied on to provide a mechanism for EU-wide regulatory development. Thus, harmonization remains a relevant avenue for pursuing EU policies in the field of company law.

Regulatory Initiatives and Institutional Path Dependence

As discussed earlier in this chapter, it is important to recognize both the effects of the interaction between regulation and the institutional environment and the implications this has for regulation. In their recent study on the development of the Swedish corporate governance model and international corporate governance convergence, Henrekson & Jakobsson highlight the importance of the institutional framework for the outcome of regulatory intervention targeting corporate ownership and corporate governance. [161] They find that even if there has been pressure on the traditional models of exercising control in Sweden (i.e., the use of different classes of shares or pyramid structures), the result has not been a corresponding increase in dispersed ownership. Instead, concentrated ownership has been retained through ownership arrangements outside the stock markets – i.e., by increasing private equity ownership and by Swedish companies becoming subsidiaries of foreign corporations. Henrekson & Jakobsson explain this with reference to the distribution of corporate authority. In Sweden, as in certain other EU jurisdictions, the division of powers between managers and shareholders favors shareholders. Controlling shareholders, then, can effectively use the shareholders' meeting to control the company. This, again, can be seen as a result of a history of concentrated ownership where controlling shareholders have maintained control of corporations and have been able to use legal means to do so. Henrekson & Jakobsson claim that Swedish companies with dispersed ownership continue to have weak managers and that this ownership structure remains unstable. This suggests that merely changing certain elements related to the structure of corporate ownership – such as regulatory mechanisms or market acceptance of control mechanisms – does not lead to actual changes in that structure.

[158] Johnston (2009), *supra* note 4, at 115.
[159] Case C-212/97, Centros Ltd v Erhvervs- og Selskabsstyrelsen [1999] ECR I-1459.
[160] *See* Guido Ferrarini & Geoffrey P. Miller, *A Simple Theory of Takeover Regulation in the United States and Europe* 15 (New York University Law and Economics Working Paper 197, 2009), *available at* http://lsr.nellco.org/nyu_lewp/197.
[161] *See* Henrekson & Jakobsson, *supra* note 22.

This has important implications for supranational (EU) regulation. The effects of regulation will depend on the applicable market structure and the broader institutional environment, including the effectiveness of legal systems and the political environment.[162] With respect to supranational regulation, it is important to recognize that the effects of the same EU-level rule or regulation can vary from one member state to another depending on these factors and may favour actors in one jurisdiction over those in another. The introduction of regulation not tailored to the relevant institutional environment can, in fact, be counterproductive. For example, with regard to takeover regulation in the EU, regulatory initiatives have been based, in part, on UK regulation. As has been discussed, however, in companies with concentrated ownership the effect can be the reverse of that experienced by companies with dispersed ownership. As the stock markets in many EU member states are based on concentrated ownership and a blockholder system, instruments seeking to undermine blockholding may undermine the whole system rather than result in dispersed ownership and the market systems that dominate the United Kingdom and the United States. Henrekson & Jakobsson argue that this could result in "an erosion of stock markets in Europe" and find evidence that such a development is already underway in Sweden.[163]

As has been stated, EU rules need to be better tailored to the each state's institutional environment to have similar functions and effects throughout the EU. Consequently, the current regulatory approach in the Takeover Directive may be flawed.

Political Aspects of EU Corporate Governance Regulation

As described above, the EU Takeover Directive was adopted after a political and legislative process that lasted some two decades. Proposals for a directives failed to pass the EU Parliament, and the version ultimately approved was a compromise described by the then Commissioner for the Internal Market as not worth the paper it was printed on.[164] In particular, the optional nature of the board neutrality rule and the break-through rule were deemed problematic in this respect. The EU-level political process involved intense lobbying by key industry groups pursuing their self-interest and by governments protecting their industrial structure. However, the political challenges of the Takeover Directive were well known at time of drafting. First, a salient question is which political alliances might have been developed to allow the directive to pass without the same degree of compromise. A further question is whether the provisions of the directive could have been structured or designed to better meet the main concerns of key constituencies while still addressing EU-level policy concerns.

The scope of this study does not allow for a comprehensive review of the politics of the Takeover Directive. However, this chapter will briefly consider the political effects of the EU framework with respect to the regulatory dynamics of corporate governance regulation in general. Some scholars believe that as of EU-level regulation develops, traditional industry groups will be able to coordinate their actions on an international level and focus their efforts to lobby for favourable EU level regulation. However, others argue that the EU framework creates a multilevel framework of regulation, with the features of each level favouring or

---

[162] See Johnston (2009)*, supra* note 4, at 151 and 181.
[163] *See* Henrekson & Jakobsson, *supra* note 22.
[164] *See* Vanessa Edwards, *The Directive on Takeover Bids – Not Worth the Paper It's Written On?,* 1 EUR. COMPANY & FIN. L. REV. 416, 439 (2004).

disadvantaging various constituencies in the pursuit of their interests.[165] For example, key industry groups may have considerable political leverage at the national level but may be unable to affect EU-level regulation in the same way. Moreover, Ferrarini & Miller argue that national-level takeover regulation is more likely to favour target companies and their management, while the relative position of institutional investors may be better at the EU level.[166] Callaghan points out that the EU contributes to the development of a multilevel governance framework – also with respect to corporate governance regulation. Callaghan argues that this creates new strategic opportunities for interest groups,[167] and claims that the EU institutional set-up allows for competing political coalitions to simultaneously advance different reforms, thus limiting the possibility of interest groups monopolizing policy.

It has been noted that EU regulation has been introduced with greater ease in areas where national-level institutions have failed to develop. There is less resistance to the introduction of new regulation when there are no national level structures or interest groups that are immediately challenged. For example, there has been less resistance to the introduction of EU-level financial services regulation as many EU member states have lacked developed or active markets and there have been few national structures to defend.[168] Thus, introducing a system largely based on models from the United Kingdom has met with relatively little resistance. Moreover, with regard to the Takeover Directive, it should be noted that the break-through rule was adopted only in the Baltic States, which had little or no experience of public takeovers and thus no immediate concerns over the introduction of the rule. However, distinct company law and corporate governance systems have developed at the national level in the older EU member states, and change will be met with political resistance. Two legal responses to such resistance, opt-in and opt-out systems, have already been discussed. However, other legal strategies include grandfathering and dual regulatory systems. These strategies allow the retention of existing structures, while preventing the creation of such structures after the adoption of the new regulation. A dual regulatory system would allow existing structures to prevail but would restrict their use. For example, companies with control enhancing mechanisms could be restricted from taking advantage of new EU-wide freedoms. For instance, new market places have been opened that are only available to companies that apply new regulatory requirements.

The conclusions to be drawn from the discussion above include the importance of identifying the constituencies affected by proposed legal intervention and the political alliances that can be formed to allow intervention to pass the political process. The constituencies that are supportive of intervention may not be the same in different jurisdictions. It is also important to seek regulatory solutions that balance policy requirements with the key concerns of politically influential constituencies. If possible, regulation should be designed to achieve the intended policy goals while taking these concerns into account. Below, this study will seek to identify the key concerns that large shareholders are likely to have in an environment of concentrated ownership and explore whether any legitimate concerns can be catered for by developing the structure or design of EU-level takeover regulation while still pursuing the policies underlying the adoption of the directive.

---

[165] *See* Helen Callaghan, *How Multilevel Governance Affects the Clash of Capitalisms* (MPIfG Discussion Paper 08/5), available at www.mpifg.de (publications, discussion papers).
[166] Ferrarini & Miller (2009), *supra* note 160, at 15.
[167] Callaghan, *supra* note 165, at 10.
[168] Armour & Ringe (2011), *supra* note 2, at 27.

Enforcement - the Effects of Regulation

There has been concern that the implementation of EU corporate regulation has not been uniform and that the enforcement of EU regulations has varied significantly among the member states.[169] These concerns also need to be taken into account in the design of regulatory mechanisms. Enforcement issues are not unique to supranational regulation; rather, they are a general consideration in the design of legal strategies. However, the variation of local-level enforcement certainly adds to the complexity of EU-level regulation. Consequently, when it comes to harmonization, the EU cannot rely of the efficiency of national enforcement mechanisms. However, the EU does provide a framework for monitoring enforcement in the form of its own court system. The precedents of the ECJ in the field of corporate law have provided an important basis for interpreting EU-level corporate regulation and have had a considerable effect on the development of EU corporate law. However, throughout the European Union corporate matters are still dealt with by national court systems with varying expertise. For example, this is why Gilson & Schwartz have argued that matters relating to the relationship between majority and minority shareholders should be directly taken up with a European-level corporate court.[170] Such an initiative is to be be applauded, and English courts with experience of corporate matters (mainly in London) could well provide the basis for developing a European-wide corporate court system. However, such court systems are currently unavailable. Moreover, as legal processes are time-consuming and financial interests may be great and matters urgent, the court framework leaves much to be desired. Furthermore, reliance on courts may require the appropriate incentivization of aggrieved parties to use the courts (or at least that there are no significant disincentives to do so). Typically, potential plaintiff minority shareholders will face coordination problems caused by their having only a limited financial interest proportional to their level of shareholding while carrying the full risk of legal costs for the dispute at hand.

C. Designing EU Legal Strategies for Control Transactions with Concentrated Ownership

The previous discussion assessed certain factors to be considered in the choice of legal strategies for EU-level corporate governance regulation. The choice of strategies is first affected by the characteristics of the relevant relationships and consideration of the ability (or lack thereof) of “principals” to monitor “agents”. It should be recognized that different corporate governance forms and mechanisms can be equally effective at addressing problems related to agency relationships. Thus, EU-level regulation targeting specific mechanisms will have different, even counterproductive, effects in different jurisdictions. EU-level legal strategies should not disenfranchise specific forms of ownership or governance but, instead, should seek to address the potential for abuse within existing governance structures. It is important to identify the relationships vulnerable to abuse and then apply appropriate legal strategies tailored to the institutional environment. In this respect it was suggested that regulatory strategies might offer the best protection for minority shareholders, who may face coordinating challenges in the context of concentrated ownership. However, in the context of EU regulation, it may be necessary to consider the special characteristics of supranational regulation when assessing which combination of legal strategies to apply.

[169] *See* Enriques & Gatti (2009), *supra* note 2.
[170] *See* Gilson & Schwartz (2012), *supra* note 103.

Enhanced Legal Strategies

For the reasons stated above, ex ante legal strategies that target a specific form of ownership or governance may be particularly counterproductive in the EU context. Gilson & Schwartz argue, for example, that an efficient ex post legal strategy is superior to ex ante regulatory strategies that impede the use of legal solutions that may be efficient in different markets.[171] However, at the EU level it should also be recognized that the nature and quality of legal systems and institutions varies across jurisdictions. Moreover, as discussed, minority shareholders may lack sufficient incentives to turn to the courts. However, even in these circumstances it may be possible to increase the effectiveness of legal standards by regulating the premises for legal adjudication. The enforcement of standards could be enhanced by setting special criteria, such as an "entire fairness" standard or by using rebuttable assumptions with regard to related-party transactions. Changing the burden of proof in this way could affect the enforcement of standards. The use of certain governance strategies could be facilitated in the same way.

EU-level principles-based directives have generally been issued on the premise that member states can implement them in ways that fit the characteristics of their national legal system. In the Takeover Directive, member states were allowed to choose whether to implement some of the more controversial provisions – the neutrality rule and the break-through rule (opt-in/opt-out). The directive also allowed member states latitude as to the relevant threshold for triggering squeeze out rights and obligations. The optionality provided for in the Takeover Directive was an ad hoc compromise to resolve a political deadlock, but as such it may not be the failed mechanism that critics suggest. Instead, the problem might simply be that the optionality provided in the Takeover Directive is not sufficiently detailed. A case can be made for introducing functionally equivalent rules, where policy goals are set and pursued through a variety of legal strategies and regulatory mechanisms tailored to different environments and governance systems. In designing EU-level regulation, it may be important to examine the underlying problems rather than formal corporate governance structures and then to find legal strategies that best address the relevant problem in the given institutional context. Instead of opt-in and opt-out mechanisms, EU directives could provide for a limited menu of regulatory choices, or the directives could provide for different rules to be applied in different corporate environments, or allow optionality at the company level[172]. Indeed, Enriques, Gilson & Pacces propose a regime, whereby default rules are introduced at the EU level, but individual companies can opt for more restrictive takeover regimes – allowing for market-based company-specific solutions[173]. Such a regime would provide one solution for regulating varied environments, such as the EU. The standards-based strategies discussed above also allow for an ex post assessment of agent behavior and may provide an instrument that is not dependent on formal governance structures. In this way, similar policy goals can be pursued throughout the EU while allowing solutions adapted to specific governance models to be applied at the national level or even at the level of individual companies.

A related question regarding the choice of legal strategies is how regulation can avoid challenging the key parameters of existing governance systems. Concentrated ownership systems may rely on monitoring by controlling shareholders, who also seek to defend their

[171] *Id.*
[172] *See* Luca Enriques, Ronald J. Gilson & Alessio M. Pacces, *The Case for an Unbiased Takeover Law (With an Application to the European Union)*, 4 HARVARD BUS. L.R. 85 (2014).
[173] *Id.*

control positions. This also suggests that ex ante rulemaking that restricts specific forms of governance might face significant political opposition. Instead, for example, general standards addressing the potential abuse within a given governance system might be more appropriate. Controlling shareholders are likely to be more opposed to regulation directly challenging their control than to standards restricting abuse of that control. Other methods to address such political opposition include "grandfathering" – i.e. allowing existing structures that predate new regulatory initiatives, even if they are not aligned with the regulatory requirements. Other approaches include regulatory dualism, whereby regulatory requirements are applied only in certain contexts, such as for companies listed on regulated exchanges, while allowing companies listed on other market places to deviate from the requirements. The EU takeover regime, for example, is required to be applied to companies listed on regulated exchanges, and mandatory bid requirements are not necessarily applied to companies traded on other types of market places.

Finally, with respect to the regulation of control transactions, it is unclear whether takeovers in themselves are the best mechanism for transferring control throughout the EU; similarly, there is doubt as to whether takeover regulation should be the key mechanism for addressing corporate governance problems related to the transfer of control. Based on the reported differences in the levels of private benefits of control in different EU member states, it is important to focus more generally on developing corporate governance regulation that limits private benefits of control thus encouraging value-increasing control transfers.

V. ASSESSING THE EU REGULATORY APPROACH TO CONCENTRATED OWNERSHIP AND CHANGE OF CONTROL

In the previous section I discussed the relationship between concentrated ownership and corporate governance on a general level and examined regulatory approaches for dealing with governance problems related to concentrated ownership. The study will now turn to a discussion of how the EU has dealt with concentrated ownership in connection with EU takeover regulation, assessing the legal strategy chosen by the EU Commission in this regard. The goal of the discussion is to clarify the extent to which the characteristics of concentrated ownership are reflected in EU regulation. The discussion will also address the political dynamic of takeover regulation at the EU level in terms of how regulation might reflect the concerns of key interest groups. The study will then provide alternative strategies or regulatory designs and assess the EU-level response.

A. SETTING THE PREMISES FOR CONTROL TRANSFERS

Addressing Self-Dealing

As discussed above, a key problem in the context of concentrated ownership is self-dealing, i.e., when a controlling shareholder enters into transactions with the company on other than arm's-length terms and conditions. Alternatively, the controlling shareholder might choose to prevent opportunities otherwise available to the company. As was stated earlier, concentrated ownership can be a competitive form of corporate ownership provided that private benefits of control are restricted. Moreover, the assertion was made that controlling shareholders are more inclined to transfer control if private benefits are unavailable. It seems then that a prerequisite for developing a market for corporate control in an environment with a prevalence of concentrated ownership is the restriction of private benefits of control.

In the context of concentrated ownership, the key issues in the extraction of private benefits of control through related party transactions concern the relationship between the controlling shareholder and the minority or outside shareholders. As earlier noted, Kraakman et al. suggest that regulatory strategies may be called for to overcome the coordination problems of minority shareholders. For example, "Standards" can be used to subject related-party transactions with controlling shareholders to an ex post assessment of fairness. "Rules"-based strategies may be less suited to related-party transactions, as preventing such transactions altogether may not serve the interests of the corporation and would also challenge a traditionally basic element of control. "Affiliation terms," such as mandatory disclosure, may also be appropriate. Other mechanisms that may be considered include relying on independent and disinterested board members to act as trustees, and "decision rights" such as subjecting related-party transactions to shareholder votes if minority shareholders are deemed to be able to overcome coordination problems. Kraakman et al. also suggest that enforcement mechanisms should typically be based on public intervention, as minority shareholders would otherwise be hindered by coordination problems.[174] Disclosure can be related to public enforcement, whereby inadequate or false disclosure could lead to censure by public authorities. On the other hand, the "standards"-approach applied in many jurisdictions relies on enforcement by courts, which requires legal action by minority shareholders. In many cases, the right to challenge related-party transactions in court may require a minimum level of share ownership, further raising the bar for enforcement.

At the EU level, certain steps have been taken to restrict self-dealing. With respect to publicly listed companies, the EU Commission has also issued recommendations on disclosure requirements for related-party transactions and has introduced annual disclosure obligations in this regard.[175] Under IFRS reporting, as implemented in the EU, disclosure of related-party transactions are included in annual financial statements.[176] The EU Commission has given further attention to these issues. In its 2011 Corporate Governance Green Paper,[177]the EU Commission calls for opinions on the need to increase minority protection mechanisms, among others. In the Corporate Governance Green Paper, the EU Commission questions the sufficiency of existing investor protection mechanisms to protect minority shareholders in companies with controlling shareholders. In particular, the Commission poses the question of whether national corporate governance mechanisms based on the "comply or explain" principle are effective in this environment. The Commission refers to mechanisms that would subject significant related-party transactions to a statement by an external, independent expert or a decision by the meeting of shareholders.[178] The Corporate Governance Green Paper also refers to suggestions of precluding controlling shareholders from voting in such situations.[179] However, such proposals include the risk of the minority using this right in an opportunistic

[174] Armour, Hansmann & Kraakman in Kraakman et. al. (2009), *supra* note 10, at 52.
[175] *See* Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the Annual Financial Statements, Consolidated Financial Statements and Related Reports of Certain Types of Undertakings, Amending Directive 2006/43/EC of the European Parliament and of the Council and Repealing Council Directives 78/660/EEC and 83/349/EEC, OJ 29.6.2013, L182/19.
[176] *See* EU Transparency Directive ([2004] OJ L 390/38), Art 5(4).
[177] *See* Corporate Governance Green Paper, *supra* note 9.
[178] Corporate Governance Green Paper, *supra* note 9 at 17. The increased transparency of the shareholders' meeting may prevent opportunistic behaviour. It is also suggested that the party to the transaction in question be banned from voting at the shareholders' meeting.
[179] Corporate Governance Green Paper, *supra* note 9.

manner, in effect even extracting rents from the controlling shareholder,[180] thus directly challenging existing control structures.

Rather than challenging the control of large shareholders or allowing opportunistic behavior by minority shareholders, supranational legal strategies adapted to concentrated ownership might seek to ensure that private benefits of control are appropriately restricted. In this respect, disclosure requirements seem to form an appropriate basis for addressing the problems at hand. To the extent that disclosure is deemed insufficient, other steps might also be considered. One proposal that may increase the threshold for controlling shareholders to enter into abusive self-dealing is the introduction of an “entire fairness” standard in related-party transactions – i.e., to shift the burden of proof with respect to the fairness of such transactions, with minority shareholders given the right to sue on behalf of the company. While it may be argued that a controlling shareholder has no fiduciary or similar duty towards other shareholders based on ownership of shares alone, such duties could be introduced for circumstances where a controlling shareholder chooses to enter into business transactions with the company and thus has a conflict of interest. Even if the enforcement of an entire fairness standard requires enforcement through the courts by minority shareholders, the shifted burden of proof might support the position of the minority. A minimum level of shareholding could be introduced to prevent opportunistic lawsuits.

An additional regulatory step could be the introduction of independent directors elected by minority shareholders. Independent directors have sometimes been deemed a relatively weak instrument for monitoring controlling shareholders, as the controlling shareholder often has a de facto veto on board elections in countries where boards are elected by majority vote and/or nominated by board committees or even committees representing the largest shareholders. Italy has introduced a mechanism whereby board members are elected by a relative vote and where minority shareholders consequently have an impact on nominating and electing independent board members.[181] The election system could be designed to allow a controlling shareholder to maintain control of the board while also adding balance to the board by including members who have a mandate from outsider shareholders. This would not challenge the control of the controlling shareholder, and would consequently not challenge the basis of governance systems based on concentrated ownership. However, it would introduce an increased degree of legitimacy for independent board members.

Facilitating Control Transfers

If controlling shareholders can only extract very limited private benefits of control, they may be more inclined to transfer control when they can no longer provide an efficient monitoring function. If the level of private benefits of control is no higher than the costs of monitoring and the costs of maintaining an undiversified investment position, the controlling shareholder may be inclined to agree to value increasing transfers of control. However, as suggested by Kirchmaier & Grant, there may be disincentives for a controlling shareholder to transfer control even in such circumstances. In jurisdictions where concentrated ownership is prevalent the institutional environment is likely to facilitate maintaining control positions. The

---

[180] Luca Enriques, Gerard Hertig & Hideki Kanda, *Related-Party Transactions*, in Kraakman et al. (2009), *supra* note 10, at 180.
[181] *See* Legislative Decree No. 58 of 24 February 1998 Consolidated Law on Finance pursuant to Art. 8 and 21 of Law No. 52 of 6 February 1996, *available at* http://www.consob.it/mainen/documenti/english/laws/fr_decree58_1998.pdf?.

question arises as to what the appropriate legal strategy should be for regulating change of control transactions in these circumstances.

Controlling shareholders generally have an effective veto right over control transactions, and control is likely to be heavily entrenched in existing regulatory frameworks. As discussed earlier, the ability to control the corporation and to decide whether to relinquish that control is a key element of concentrated ownership. Thus, controlling shareholders are likely to resist regulatory initiatives that challenge their control rights. Instead, regulatory initiatives could seek to encourage controlling shareholders to transfer control voluntarily when they no longer perform an effective monitoring function and provide sufficient protection for minority shareholders in the form of exit rights.

Regulation may also seek to discourage the maintenance of control when it has become ineffective. In this respect, the EU has tended to favor market-based mechanisms. For example, it has been proposed that external financiers could provide financing in the form of convertible debt instruments to monitor firm performance.[182] If financial targets were not met, the instruments would be convertible in a way that would dilute the holdings of the controlling shareholder. Such instruments would typically be introduced as the performance of the controlling shareholder deteriorates – i.e., the convertibles would be introduced as a condition for further financing. Such monitoring mechanisms could also be agreed upon ex ante when expanding corporate ownership to control for shirking. Nevertheless, market-based mechanisms may be insufficient to deal with these issues, requiring other regulatory approaches with a similar effect to raise the opportunity costs of maintaining control. However, the introduction of such regimes is likely to be heavily contested by interested constituencies and may be particularly difficult to introduce at the EU level.

B. CONCENTRATED OWNERSHIP AND THE FUNCTION OF TAKEOVERS IN THE EU

Before turning to the mechanisms adopted in the Takeover Directive, this section will provide a brief overview of the arguments underlying EU-level regulatory intervention in relation to takeovers.

The EU Commission emphasizes the role of takeovers as a tool for corporate restructuring and for monitoring management. According to its preamble, the Takeover Directive sets out to "establish minimum guidelines for the conduct of takeover bids and ensure an adequate level of protection for holders of securities throughout the Community"[183] As a matter of policy, the EU Commission has argued extensively that takeovers are an important mechanism for corporate restructuring and a key element for integrating the European capital markets. An EU Commission staff report on the implementation of the Takeover Directive stated the matter as follows:

> The Commission's proposal was based on the assumption that takeovers offer a number of benefits for companies, investors and ultimately for the European economy as a whole. Takeovers may be efficient drivers of value creation. They facilitate corporate restructuring and consolidation and provide a means for companies to

[182] Gilson (2006), *supra* note 57, at 1677-1678. Gilson reports that such instruments have been used in Italy, where Fiat was required to take on debt convertible to equity if financial targets were not met when it was raising USD 3 billion for restructuring. If conversion had occurred due to bad performance, the controlling stake of the Agnelli family would have been diluted, leading to the financing banks becoming the largest shareholder.
[183] Directive 2004/25/EC, Preambles (25).

> achieve an optimal scale, a precondition for competing effectively on an integrated European market as well as on the global market. They help in disseminating good management practices and technology, and thus improve the quality of management and corporate performance. Furthermore, takeovers discipline management and stimulate competition. Such transactions are also beneficial for investors, allowing them to obtain a better return on their investments.
>
> The aim of the Commission's proposal was to help exploit such benefits at European level and to promote integration of European capital markets by creating favourable conditions for the emergence of a European market for corporate control: efficient takeover mechanisms, a common regulatory framework and strong rights for shareholders, including minority shareholders.[184]

Takeovers and takeover regulation have a different function depending on the structure of ownership. Naturally, takeover regulation is generally seen to provide rules for facilitating efficient restructuring of public corporations.[185] Thus, rules should be designed to facilitate the transfer of control as efficiently as possible. However, regulation can also address conflicts of interest among the key corporate constituencies such as management and large and small shareholders, as well as other stakeholders, in change of control situations. In this context, takeover regulation also has a general corporate governance function. As earlier stated, in companies with dispersed ownership, takeovers and takeover regulation provide a monitoring mechanism for controlling management. The threat of a hostile takeover will provide an incentive for management to perform effectively and focus on shareholder interests. With regard to companies with concentrated ownership, takeover regulation can provide mechanisms for protecting minority shareholders' interests in the form of appraisal rights and equal treatment requirements.

In the EU, the question arises as to whether takeovers in fact provide the tool for facilitating the market for corporate control in the first place. The use of takeovers in the EU member states varies, due to the variety of ownership structures and regulation.[186] It has been observed that "just as there are diverse national varieties of capitalism within the EU, so there are varieties of takeover markets, underpinned by different institutions, corporate governance norms and ownership patterns."[187] In the United Kingdom, with a fairly dispersed ownership structure, takeovers are common, and an advanced regulatory framework has developed over the years.[188] In some other EU markets, most notably in Sweden, takeovers are also fairly common, despite relatively concentrated ownership,[189] while in other member states takeovers, especially of the hostile kind, remain rare.[190] In many member states, takeovers have been controversial and subject to political debate and criticism by labour representatives and the

---

[184] *EU Commission Staff Working Document: Report on the implementation of the Directive on Takeover Bids*, Brussels, 21.02.2007, SEC(2007) 26 [hereinafter EU Staff Working Document (2007)].

[185] *See* Mike Burkart, *The Economics of Takeover Regulation* (SITE Working Paper 99/06, Stockholm School of Economics), *available at* http://www2.hhs.se/personal/MikeBurkart/papers/w_p5.pdf.

[186] *See* Marina Martynova & Luc Renneboog, *Mergers and Acquisitions in Europe* (ECGI Finance Working Paper 114, 2006), *available at* http://ssrn.com/abstract_id=880379.

[187] Clift (2009), *supra* note 4, at 55-56.

[188] *See* John Armour & David Skeel, *Who Writes the Rules for Hostile Takeovers, and Why? – The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 GEO.L.J. 1727 (2007).

[189] Ulf Bernitz, *Mechanisms of Ownership Control and the Issue of Disproportionate Distribution of Power*, in COMPANY LAW AND ECONOMIC PROTECTIONISM (Ulf Bernitz & Wolf-Georg Ringe, eds., 2010); *see also* THE NORDIC CORPORATE GOVERNANCE MODEL 57 (Per Lekvall, ed., 2014).

[190] Martynova & Renneboog (2006), *supra* note 186, at 6.

media. Protectionist tendencies have been observed in many significant member states, with governments uncomfortable with foreign buyers.

As the significance of takeovers as a method of transferring control varies between EU member states, in terms of the EU Commission's goal of facilitating the market for corporate control, a pertinent question is whether the choice to focus on takeovers as the key mechanism for change of control was correct or sufficient.. Perhaps other means commonly used to transfer control should also have been identified and the appropriate regulatory responses developed. For example, prior to the introduction of the Takeover Directive, control transfers occurred through sales of controlling blocks.[191]

C. THE TAKEOVER DIRECTIVE

The Takeover Directive sought to address certain agency problems related to concentrated ownership in the context of control transfers. As will be discussed in more detail below, the directive sought to limit the ability of controlling shareholders to extract private benefits of control in the form of control premiums. The directive also sought to address shirking and the entrenchment of control. The EU Commission identified the problems addressed in the directive as follows:

> The purpose of the directive in facilitating takeover activity through efficient takeover mechanisms required the removal of some of the main company-related obstacles permitted under national company law; these obstacles meant that takeovers could not be undertaken on equal conditions in the different Member States.
>
> Two key provisions of the Directive — board neutrality and breakthrough — were considered to be particularly important in this respect. These rules restrict the use or availability of two different types of instruments which can be exploited by companies to thwart hostile bids (takeover defences). To take account of the differences in the takeover defences applied throughout the EU, the Commission's proposal covered both types of defences in order to ensure a level playing field between Member States.[192]

The protection of minority shareholders was a central theme in the Takeover Directive. One of the mechanisms introduced in this regard was the mandatory bid as outlined in the following:

> Minority shareholders are protected in a number of ways under the Directive. The mandatory bid rule provides that if a person acquires control over a company, he/she is obliged to make a full takeover bid for all the remaining voting securities of this company at an equitable price. This rule protects minority shareholders by granting them a right to sell their shares in the event of a change of control as well as the benefit of the premium paid for the controlling stake. The introduction of the mandatory bid obligation and/or the equitable price rule in those Member States where such a rule did not apply before transposition and the setting of a threshold

[191] *See* Jens Köke*, Control Transfers in Corporate Germany: Their Frequency, Causes, and Consequences* (ZEW Discussion Paper No. 00-67, 2001), *available at* http://ssrn.com/abstract=256967.
[192] EU Staff Working Document (2007), *supra* note 184, at 3.

lower than the one applied before transposition will increase minority shareholders' rights in some Member States."[193]

The mechanisms in the directive that address concentrated ownership and control enhancing mechanisms are the break through rule and the mandatory bid rule, which will be discussed in more detail below. The effects of these mechanisms in an environment of concentrated ownership have been analyzed in great detail, and concerns have been raised about the mechanisms' adequacy in promoting the goals of the Takeover Directive. Next the study will describe these views and consider whether the problems the mechanisms are designed to address are, in fact, the real problems preventing the development of the market for corporate control in the EUand if they are, whether the instruments chosen are appropriate for this task. The study will not discuss board neutrality, regardless of the significant controversy surrounding it at the time of the directive's adoption, the reason being that in the presence of a controlling shareholder, the role of the board is of lesser significance with regard to change of control, as the consent of the shareholder is generally necessary for a transfer of control to be successful.

The Break-through Rule

The EU Commission had voiced concern about the effect of control enhancing mechanisms on change of control transactions. The High Level Working Group identified different types of takeover barriers based on how they addressed the change of control process. First, there may be regulatory or practical barriers to a potential buyer purchasing shares. The relevant mechanisms include ownership caps, restrictions on the transferability of shares, lack of access to underlying shares where depositary receipts are subject to trading, and different mechanisms reducing the possibility of acquiring sufficient shares to obtain control (cross-shareholding, pyramids). A second set of barriers limit the exertion of control by a potential buyer. Here, the mechanisms typically include vote cutters and share classes with different voting rights. Barriers can also be established with regard to exertion of control at the board level. The mechanisms identified by the High Level Working Group included co-determination requirements, special rights to appoint directors and staggered boards. The large number of these barriers, and in particular the structures related to the use of control, demonstrate how prevalent the separation of cash flow rights and control is in EU corporate governance and what a central characteristic it is of European ownership models, so much so, in fact, that it may be inappropriate to approach these mechanisms as phenomena that can be "regulated away." They should instead be seen as a part of the institutional environment.

In the Takeover Directive, the idea of the break-through rule is to provide a framework in takeover situations for disregarding mechanisms that are obstacles to the execution of the transaction. The break-through rule removes restrictions related to the transfer of securities or to voting rights with respect to the offer and the offeror in connection with the execution of a tender offer. Shareholders should be able to tender their shares regardless of transfer restrictions in articles of association or contracts, and restrictions on voting rights should not apply to the shares of the offeror at shareholders' meetings where any decisions regarding defensive measures are taken. The other key provision of the break-through rules is that when a buyer has acquired a certain majority of the shares ("75 % or more of the capital carrying voting rights"[194]), he or she is no longer subject to restrictions on the transfer of shares or on

[193] *Id.* at 9.
[194] Takeover Directive, art. 11, para. 4.

voting rights related to the target shares. Furthermore, super voting shares would carry only a single vote per share at the meeting of shareholders called by the buyer following the closure of the bid to amend the articles of association or remove or appoint board members. In the Takeover Directive, the break through rule provides for equitable compensation to be paid to shareholders whose rights have been negatively affected by the application of the rule.[195] In itself, the Takeover Directive does not provide for a mechanism for the determination of the loss, nor does it suggest who should be obligated to compensate such loss.[196] This raised concerns in many member states about the constitutional issues arising from situations where the directive proposes to intervene in ownership interests.[197]

In an environment of concentrated ownership where control enhancing structures are used, it has been argued that the break-through rule facilitates takeovers and corporate restructuring,[198] as it eliminates the effects of the structural takeover defences set up by controlling shareholders. The break-through rule is deemed to allow change of control transactions which would otherwise be prevented by a controlling shareholder with a sufficient share of the votes in the target company. It has also argued that the break-through rule redistributes the takeover gains from the controlling shareholder to the bidder.[199] As the controlling shareholder can be circumvented by the application of the break-through rule, he is unable to extract a control premium. In this regard, a comparison has been made between mandatory bid provisions and break-through rules.[200] With the mandatory bid rule, a bidder would agree to purchase the control block at a price that includes the control premium and would be forced to offer the same price to all other shareholders. Applying the break-through rule, however, the bidder would be able to proceed with a lower price, as the controlling shareholder would lose his "lock" on the company. The controlling shareholder would not be separately compensated for private benefits of control, and this, so it is argued, should increase dispersed ownership. [201]

Ultimately, the implementation of the board neutrality rule and the break-through rule was optional for the member states, as there was insufficient political support for the adoption of these provisions on a binding basis. As a result, most member states elected not to implement the break through rule. It should be noted that the Takeover Directive provides that states choosing not to implement the provisions in Article 11must provide the means for individual companies to apply these provisions on a company specific basis. Nevertheless, to date very few companies seem to have adopted a break through provision.[202] Some commentators have supported the regulatory approach taken by the Commission with regard to the break-through rule and have been disappointed with the EU Commission's failure to push through its regulatory agenda in the face of opposition from a number of member states.[203] However, a pertinent question is whether this approach was well advised in the first place, given that it

---

[195] Takeover Directive, art. 11, para. 5.
[196] *See* Joseph A. McCahery & Luc Renneboog, with Peer Ritter & Sascha Haller, *The Economics of the Proposed European Takeover Directive* (CEPS Research Report, Finance and Banking, No. 32, April 2003, p.58 ff.).
[197] Marco Becht, *Reciprocity in Takeovers* 3 (ECGI Law Working Paper 14/2003), *available at* http://ssrn.com/abstract=463003.
[198] Goergen, Martynova & Renneboog (2005), *supra* note 31, at 16.
[199] *Id.*
[200] *See* Berglöf & Burkart (2003), *supra* note 18.
[201] Goergen, Martynova & Renneboog (2005), *supra* note 31, at 17.
[202] EU Staff Working Document (2007), *supra* note 184, at 7.
[203] *See* Papadopolous (2007), *supra* note 7.

triggered opposition sufficient to prevent the full adoption of the proposal. Moreover, a further question is whether the break-through rule per se is an effective instrument to facilitate takeovers in companies with concentrated ownership. In fact, a regulatory approach more focused on developing wider governance structures and better tailored to the differences in control structures among member states may have better contributed to the development of the market for corporate control.

In the Takeover Directive, the break-through rule only effectively addresses multiple share-class structures. For example, pyramids and cross-shareholdings remain outside the reach of the directive, a fact recognized by the High level Working Group, which initially introduced the rule.[204] The High Level Group recommended that pyramid structures be addressed by prohibiting stock exchange listings for holding companies whose sole activity is the holding of other listed companies.[205] Nevertheless, the proposal was not adopted in the Takeover Directive. Moreover, even certain multiple-voting arrangements remain outside the scope of the rule. For instance, the directive explicitly prohibits the application of the break-through rule to a system where shares of the same class are given additional voting rights when held by the same holder for a sufficient period of time. Multiple share classes are generally in use in Sweden and the other Nordic member states, while the latter mechanism is in use in France. Consequently, the break-through rule was criticized for its uneven and unfair effect among member states.[206] The Nordic countries opposed the break-through clause[207] specifically on the grounds that it failed to promote a level playing field.

Despite the controversy, research from the years immediately preceding the adoption of the Takeover Directive suggested that the break-through rule would directly affect only a small number of companies.[208] First, as discussed above, the break-through rule only affects companies with a multiple-class share structure. Moreover, for the proposed 75 percent break-through threshold to be effective, ownership must be sufficiently dispersed. Empirical research suggested that, given these limitations, less than 3–4 percent of companies listed in the EU would have been affected by the introduction of the break-through rule.[209] It has also been observed that if the break-through rule had been introduced, rather than remaining passive it is likely that companies and shareholders would have taken steps to ensure the maintenance of their control positions by adopting alternative control structures.[210] Furthermore, new companies would have been able to adopt a control structure not covered by the break-through rules. In the current regulatory framework, such structures would

---

[204] *See* High Level Group Report*, supra* note 4.
[205] Jaap Winter, *The Good, the Bad and Ugly of the European Takeover Directive* in European Takeovers: The Art of Acquisition 27 (J. Grant, ed., 2005).
[206] *See* Ulf Bernitz (2010), *supra* note 189. While the merits of "level playing field" or "fairness" arguments do not seem wholly convincing, it is interesting, and indicative of EU regulatory processes, that the proposal targeted structures prevalent in smaller EU member states while not addressing functionally similar structures in larger EU states.
[207] The position of the Nordic countries may, of course, have been affected by strong lobbying from shareholder groups as much as by concerns over a level playing field. For example, in Sweden the Wallenbergs ,rely largely on multiple-class share structures to maintain control in listed companies.
[208] *See* Morten Bennedsen & Kaspar Nielsen, *The Impact of the Break-Through Rule on European Firms*, 17 EUROP. J. OF LAW AND ECON. 259 (2004).
[209] John C. Coates IV*, Ownership, Takeovers and EU Law: How Contestable Should EU Corporations Be?* 6-8 (ECGI Law Working Paper 11/2003), *available at* http://ssrn.com/abstract=424720.
[210] *Id.* at 12.

include pyramids or cross shareholdings.[211] Even if a more extensive break-through rule were introduced, it is possible that other control structures would be developed over time – there is a wide array of available instruments whereby control can be cemented.

The break-through rule can also be seen as a political outcome reflecting the relative power of member states. The rule, as discussed above, mainly targets the control structures used in smaller member states, including the Nordic countries, while ignoring structures with similar effects in larger member states such as Germany and France. Moreover, it is worth noting that the vote on the directive largely followed national boundaries rather than political divisions in the EU parliament.[212]

Considering the failure of member states to adopt the break-through rule, it is salient to ask whether a less controversial design with the same effects sought by break-through rule might have been available. In fact, instead of seeking to "break-through" existing structures of ownership, regulation could have been introduced to induce the controlling shareholder to transfer control voluntarily where maintaining control was no longer efficient (when the controlling shareholder was no longer performing effective monitoring, for example), and to provide adequate protection for minority shareholders in connection with the control transfer. A regulatory solution with the same potential effect as a break-through rule vis-a-vis concentrated ownership and controlling shareholders would consist of more intrusive rules on self-dealing, rules that raised the cost of maintaining controlling stakes in unprofitable enterprises and rules that decreased the threshold for transferring control. It has been noted that in many EU member states, maintaining control positions is relatively cheap, due to the use of control enhancing mechanisms and favorable tax regimes.[213] Other instruments that could be effective in preventing such things as shirking through over-investment include minimum dividend rules, whereby minority shareholders can require that a portion of the profits be distributed as dividends. This limits the possibility of the controlling shareholder diverting profits into sub-optimal investments. As the enforcement of minority rights varies among member states, specific minority rights could be strengthened by an "entire fairness" standard with respect to related party transactions.

The provisions described above might have been better suited to governance systems based on concentrated ownership and might also have been less controversial politically. As discussed, controlling shareholders may well have been prepared to accept regulation that limited private benefits as long as they retained control.

The Mandatory Bid Rule

In the Takeover Directive, the mandatory bid rule provides that all shareholders shall be provided an exit opportunity in connection with a transfer or accumulation of control at a fair price. The rule requires a shareholder to make a tender offer for all shares and other securities pertaining to such shares upon acquiring a stake large enough to secure "control" of a

---

211 Goergen, Martynova & Renneboog (2005), *supra* note 31, at 17; *see also* Bebchuk, Kraakman & Triantis (2000), *supra* note 14.

212 *See* Helen Callaghan & Martin Höpner, *European Integration and the Clash of Capitalisms: Political Cleavages over Takeover Liberalization*, COMPARATIVE EUR. POL. 307 (2005).

213 *See* Randall Morck, *How to Eliminate Pyramidal Business Groups: The Double taxation of Intercorporate Dividends and Other Incisive Uses of Tax Policy* 136 in TAX POLICY AND THE ECONOMY, VOL. 19 (James M. Poterba, ed., 2005).

company.[214] The relevant thresholds are subject to national laws, but are generally set at a 30 percent stake in the target company. The directive also requires that an "equitable price"[215] be offered in the tender offer. This price is linked to the highest price paid by the shareholder during a certain period (between six and twelve months, at the discretion of the member state) prior to the mandatory bid obligation being triggered. One justification given for the rule is that a party obtaining a controlling position may also be in a position to exploit private benefits of control at the expense of other shareholders.[216] Consequently, the mandatory bid rule seeks to prevent inefficient transactions where the value sought by the bidder would be extracted from the target company at the cost of other shareholders rather than from increased efficiency or synergies. In any respect, such a party may be in a position to alter the company's strategy and business so that they no longer reflect the original basis of the investment of the other shareholders. In such circumstances it has been deemed appropriate to grant a viable exit opportunity to minority shareholders. Through the pricing mechanism, the rule also limits the possibility of paying control premiums to controlling shareholders in change of control transactions.

As discussed above, the mandatory bid rule has faced some criticism. The mandatory bid rule may protect minority shareholders, but it can also increase the price of takeovers and discourage bidders from attempting takeovers – even if they were value-creating.[217] Therefore, the mandatory bid rule can have negative implications in an environment with concentrated ownership, as it reduces trade in control positions. Nevertheless, it has been argued that the efficacy of the mandatory bid rule depends more on the specific circumstances.[218] Where a buyer can extract significant private benefits of control at the cost of minority shareholders, a mandatory bid rule may be called for. One explanation for the introduction of the mandatory bid rule in the EU is that the EU Commission recognized that that the preconditions for the application of the market rule – i.e., that private benefits from self-dealing were limited or capped, and that efficient enforcement mechanisms were in place – were not fully present throughout the EU . Nevertheless, the question arises as to whether the EU's focus should have been the limitation of private benefits of control from operating a corporation and the development of both standards and enforcement mechanisms in this regard, rather than the introduction of a regulatory instrument that in fact entrenched concentrated ownership and increased the threshold for launching takeover bids. If private benefits of control can be decreased in the EU, the need for the mandatory bid rule should be reconsidered. Indeed, when discussing the market rule and the equal opportunity rule earlier in this study, an

---

[214] The text of the directive reads as follows: "Where a natural or legal person, as a result of his/her own acquisition or the acquisition by persons acting in concert with him/her, holds securities of a company as referred to in Article 1(1) which, added to any existing holdings of those securities of his/hers and the holdings of those securities of persons acting in concert with him/her, directly or indirectly give him/her a specified percentage of voting rights in that company, giving him/her control of that company, Member States shall ensure that such a person is required to make a bid as a means of protecting the minority shareholders of that company. Such a bid shall be addressed at the earliest opportunity to all the holders of those securities for all their holdings at the equitable price as defined in paragraph 4."

[215] The text of the directive reads as follows: "The highest price paid for the same securities by the offeror, or by persons acting in concert with him/her, over a period, to be determined by Member States, of not less than six months and not more than 12 before the bid referred to in paragraph 1 shall be regarded as the equitable price. If, after the bid has been made public and before the offer closes for acceptance, the offeror or any person acting in concert with him/her purchases securities at a price higher than the offer price, the offeror shall increase his/her offer so that it is not less than the highest price paid for the securities so acquired."

[216] Goergen, Martynova & Renneboog (2005), *supra* note 31, at 11.

[217] *Id.*

[218] Berglöf & Burkart (2003), *supra* note 18, at 175.

important observation was that the need for a mandatory bid rule was directly related to the ability of a new buyer to extract private benefits of control. If this ability were sufficiently restricted (by a good corporate governance regime, for example), there would be no need for the rule.[219] This suggests that the application of the mandatory bid rule could be selective and based on such things as the level of minority protection.

A further question is whether the negative implications of the mandatory bid rule could have been mitigated in some way, or whether the application of the mandatory bid rule could have been limited to situations involving potential value-decreasing transactions. If the mandatory bid rule is retained, however, it may be possible to amend it to better facilitate control transfers. For example, the directive already allows for the threshold triggering a mandatory bid to be adjusted nationally, with the understanding that a higher threshold will allow the transfer of larger minority blocks.[220] Furthermore, the pricing rules in mandatory bids can be adjusted.[221] As earlier stated, the directive links the price to the highest price offered in the past six to twelve months (allowing for national discretion with regard to the time period). However, one option could be to set the minimum price paid at a certain percentage of this level – i.e., allowing some difference to be paid to compensate a controlling shareholder for monitoring costs. Again, the directive allows for exemptions from the pricing rule and even from the mandatory bid obligation altogether.[222] These exemptions could be developed further. The application of the exemptions is currently based on national discretion, allowing for the application of solutions that reflect and possibly entrench national-level governance structures. Instead of allowing exemptions to be based on national discretion, the mandatory bid rule could be modified so that exemption would apply when other mechanisms were available that sufficiently restricted private benefits of control or otherwise provided protection for minority shareholders. In some countries, exemptions from mandatory bid rules could be applied on the basis of a white wash procedure allowing minority shareholders to decide whether the transaction is approved.

The mandatory bid rule is an exit rule, and as such a regulatory strategy. However, strict application of the rule seems counterproductive vis-a-vis concentrated ownership. The introduction of the mandatory bid rule may reflect the reality that private benefits of control are still available in many EU member states. At the same time, the rule allows for national discretion with respect to the level of shareholding that triggers the bid obligation and pricing requirements. Thus, as the rule can be tailored to specific circumstances in the member states, as such it is well suited to the EU environment. However, what should be contemplated – at the very least – is the development of the exemption regimes from mandatory bid obligations allowed under the rule, both with regard to triggering bid obligations and the price requirement.

Squeeze-Out and Sell-Out

A takeover does not represent a corporate decision binding on all shareholders. Consequently, a buyer may be unable to obtain full ownership of the target company, as minority shareholders may choose to reject an offer in the hope of being able to negotiate better terms, or may merely fail to respond to the offer. Many jurisdictions provide for a squeeze out

[219] *See* Gilson & Gordon (2003), *supra* note 132.
[220] *Id.*
[221] *Id*.
[222] Takeover Directive, art. 5 para. 4.

mechanism that gives a shareholder the right to redeem the shares of remaining shareholders when he or she has obtained a significant majority of the shares of the target company. The squeeze out right eliminates the free-rider incentives of shareholders in the target company.[223] Typically, the thresholds have been set at 90 percent or higher of the shares and votes in a limited liability company. Squeeze-outs differ markedly from the mandatory bid requirement in that they allow a shareholder to redeem shares from minority shareholders. In this sense the squeeze-out right can be seen as a form of expropriation, and thus relatively high thresholds of ownership have been set for triggering this right. Minority shareholders are often granted a sell out right, entitling them to transfer their shares to a majority shareholder. Sell-out rights protect minority shareholders from the potential extraction of private benefits of control by the controlling shareholders by allowing an exit at a set price. The right also protects shareholders from being effectively locked-in due to the decreased liquidity of the holding, as in effect there may be no market for the minority shares.

The Takeover Directive introduced both squeeze-out and sell-out rules that allow member states to set the triggering level of share ownership (not to exceed 95 per cent, however). The directive requires that the majority shareholder pay a "fair price" for the shares. In cases where the squeeze-out threshold is reached after a tender offer, the price offered in the tender offer shall generally be deemed fair for the purposes of the squeeze-out.

Squeeze-out rules are another instrument that could be used to facilitate takeovers while improving protection for minority shareholders. In many cases, bidders give a high priority to certainty of execution. Even the risk of not acquiring the minimum level to allow a squeeze-out is often deemed detrimental to the launch of a transaction. Lowering the level triggering squeeze-out rights could be considered as a matter of policy. At the point where a majority shareholder holds a sufficient portion of shares to effectively control most aspects of corporate decision-making, a portfolio theory of share ownership would suggest that minority shareholders have few other relevant interests to be protected than the economic value of their investment. In takeover bids, it should be recognized, however, that the lower the level of acceptance, the higher the proportion of shareholders who deem the price offered insufficient. Nevertheless, considering the level of ownership concentration in many EU member states, the minimum threshold for squeeze-outs in the Takeover Directive could well be lowered from the current 90 percent.

This chapter has provided an assessment of certain key mechanisms introduced in the Takeover Directive with respect to addressing the agency relationship between controlling shareholders and other shareholders, and the suggestion was made that these mechanisms may not be best suited to concentrated ownership. The purpose of the discussion was primarily to demonstrate the range of regulatory alternatives available for addressing agency problems and the factors that should be considered when designing regulatory instruments. While it is clear that regulatory intervention is subject to political constraints, there is room to introduce a variety of regulatory designs, and further efforts should be made to develop the proposed regulatory instruments further.

[223] Paul Davies & Klaus Hopt, *Control Transactions*, in Kraakman et. al (2009*), supra* note 10, at 264.

VI. Discussion: Concentrated Ownership and the Takeover Directive

This study is concerned with how EU-level regulation takes into account differences in institutional structures within EU member states and the challenges they present to the harmonization of corporate governance regulation in the EU. More specifically, this chapter has discussed how the EU Takeover Directive has addressed the implications of concentrated ownership on change of control transactions. The study now turns to a summary and assessment of the directive in this regard.

This study has asserted that the structure of corporate ownership is related to the broader institutional environment, which varies among EU member states.[224] Moreover, the study has presented the findings of several studies which suggest that concentrated ownership reflects the particular institutional environment in certain EU member states, in turn affecting whether rents are extracted by controlling shareholders.[225] Empirical studies of EU listed companies have supported the view that concentrated ownership can benefit corporate performance through the monitoring function performed by a large undiversified shareholder, and that concentrated ownership or the use of control enhancing mechanisms need not necessarily be related to the extraction of private benefits of control. However, the structure of corporate ownership and corporate governance regulation is path dependent, and existing structures can be self-enforcing. Consequently, from a regulatory perspective, it seems that the main concern should be to address entrenchment of control (with concentrated shareholders) when the incumbent shareholder is no longer providing an effective monitoring function.[226] As with all institutional developments, the structure of ownership and corporate control can be entrenched and prevail even when it is no longer efficient. Moreover, corporate control is likely to be entrenched regardless of whether ownership is dispersed or concentrated, and it is rarely in the hands of minority shareholders. Certain corporate governance mechanisms may be ineffective in the context of concentrated ownership, but their effects have also been questioned in dispersed ownership environments. These observations have implications for the EU's choice of approach to regulating change of control in companies with concentrated ownership. The study argues that the Takeover Directive failed to adequately take into account the implications of entrenchment of control and the institutional complementarities of concentrated ownership. The mechanisms used in the directive may in fact have been counterproductive.

A. Assessing the Merits of the EU Takeover Directive

The regulatory solutions adopted by the EU reveal some important characteristics of EU corporate governance regulation. At the beginning of the study, reference was made to the arguments of Enriques on EU harmonization, [227] i.e., that in terms of regulatory intervention, the EU is no more adept than national regulators (probably less so) at properly identifying market failures, that the EU legislative process is vulnerable to the influence of interest groups and that EU-level regulatory outcomes often fail to increase social welfare.

First, when it comes to the Takeover Directive's identification of market failures, it is unclear that takeovers were ever a key monitoring instrument or avenue for the transfer of control in

[224] *See* Johnston (2009), *supra* note 4, at 181.
[225] A number of studies report controlling shareholders in Sweden extracting low or no private benefits of control. *See supra* note 83.
[226] See Gilson (2006), *supra* note 57.
[227] Enriques (2005), *supra* note 2.

many EU member states. Moreover, the market failure, to the extent there was one, was not necessarily related to concentrated ownership or control enhancing mechanisms but rather to the entrenchment of control due to "stealing" or "shirking" by controlling shareholders. In this sense the Takeover Directive should of course be analyzed as just one element of the regulation of change of control, other key elements being general corporate governance rules regarding minority protection and related party transactions. However, the EU's narrow focus on the takeover process may fail to sufficiently address the underlying policy concerns.

Second, for the reasons presented by Enriques, the final regulatory solution runs the risk of further increasing concentrated ownership and entrenchment by controlling shareholders. It seems that finding EU-level solutions for corporate governance matters is particularly difficult when established structures exist in the member states. Any change will of course affect the interest groups prominent in the current environment, and it is likely that regulatory solutions that challenge existing and entrenched property rights will be heavily contested. In the case of the Takeover Directive, the break-through rule and the board-neutrality rule were subject to particular criticism. Ultimately, adoption of the provisions was optional for the member states. While many states adopted the board-neutrality rule, most already had a similar rule. However, the break-through rule was only adopted by some of the Baltic States, which prior to the implementation of the Takeover Directive had neither specific takeover regulation nor an active takeover market. Indeed, they also lacked most of the structures addressed by the break-through rule.[228] It should also be noted that the break-through mechanism did not target control enhancing mechanisms in a consistent manner throughout the EU. The mechanism targeted the dual class shares used primarily in the Nordic region, while ignoring, for example, the pyramid structures, cross-shareholdings and super voting rights used predominantly in larger member states.

Third, it is unclear that a uniform, one-size-fits-all regulatory solution is appropriate for pursuing EU-wide regulatory policies. As discussed earlier, corporate governance regulation can have different effects in different jurisdictions depending on the structure of corporate ownership and the relevant legal and institutional environments. In the Takeover Directive, certain regulatory solutions were "legal transplants" from the United Kingdom. This was due, in part, to the assumption that as the UK had the EU's most active takeover markets and extensive and detailed takeover regulation, UK regulatory solutions could be used as a model for EU-level regulation.[229] However, as earlier mentioned, the institutional environment varies widely within the EU, with most member states having ownership structures very different from those in the UK. As a result, the effect of uniform takeover rules can be very different from that in the UK.

Analysis of the impact of the Takeover Directive suggests that EU harmonization initiatives in the field of corporate governance still leave much to be desired. Nonetheless, this does not necessarily mean that regulatory intervention should be left to the national authorities. While regulatory competition may produce efficient solutions, it is possible that a level of harmonized regulation is required to provide the regulatory framework with sufficient legitimacy.[230] Moreover, as regulatory competition in the field of corporate governance has not yet fully evolved in the EU, EU-level regulation remains important. Finally, as was pointed out, the EU institutions have their own regulatory agenda, and it is unlikely that

[228] See EU Commission Takeover Directive Report (2012), *supra* note 38.
[229] Johnston (2009), *supra* note 4, at 268.
[230] *Id.* at 127-128.

harmonization initiatives will decrease. Therefore it remains important to develop and improve EU-level regulatory approaches.

B. DEVELOPING THE EU APPROACH TO TAKEOVER REGULATION

The study now turns to an assessment of how the design and structure of EU-level takeover regulation might be developed and what the preconditions for such developments might be.

As such, EU-level regulatory intervention may well be warranted with respect to takeover regulation, as policies reflecting the entrenched interests of dominant corporate constituencies are likely to persist at the national level. However, it is important to develop EU corporate governance regulation that addresses both the relevant governance relationships and the challenges of entrenchment. Nevertheless, the special characteristics of EU regulation place restrictions on the kind of legal strategies that can effectively be used.

First, the study has argued that ex ante strategies may be problematic in the EU context and that the current approach of challenging the control exercised by controlling shareholders and seeking to "break-through" control enhancing mechanisms is flawed. The current regulation prevents value-increasing transactions and fails to provide incentives for controlling shareholders to transfer control, even when the current ownership model is no longer efficient. Although the break-through rule allows bidders to avoid paying control premiums provided they obtain a significantly large portion of shares, if the institutional environment supports concentrated ownership, shareholders are likely to change the structure of ownership to avoid the influence of the rule while still maintaining control.

Different governance structures and different structures of corporate ownership should be allowed to develop; however, efforts should be made to ensure that control can be transferred when incumbent structures are no longer efficient. The regulatory framework should be developed to better suit an environment of concentrated ownership by introducing regulation that – on the one hand – decreases private benefits of control (in the form of "stealing") and – on the other hand – encourages controlling shareholders to transfer control when they are no longer effective monitors (to overcome "shirking"). Private benefits of control can be regulated, for example, by adopting a standards-based approach to regulating related-party transactions. These standards can be enhanced by including mechanisms that facilitate enforcement, such as entire fairness standards and fiduciary duties, or by changing the burden of proof in situations where the risk of the extraction of private benefits of control is high. Enhanced governance strategies could also be introduced to support the position of minority shareholders. For example, mechanisms for electing board members could be developed to enhance the position of independent board members, as discussed above. Controlling shareholders are less likely to seek to prevent the introduction of mechanisms that increase the protection of minority shareholders (i.e., regulation focusing on private benefits of control), if those mechanisms do not challenge the essential elements of control over the use of corporate assets.

In connection with control transactions, it is important that controlling shareholders have an incentive to transfer control and that the minority protection mechanisms introduced do not create unwarranted disincentives for control transactions. In the context of concentrated ownership, it has become clear that break-through rules are unlikely to be an appropriate instrument for these purposes. Moreover, mandatory bid provisions can also be problematic and possibly unwarranted where private benefits of control are already restricted. In fact, legal strategies can be developed to provide sufficient minority protection in control transactions while facilitating deal security. For example, mandatory bid requirements could be modified with appropriate exemptions and pricing rules, while the threshold triggering squeeze-out rules could be lowered to increase deal security, while still providing sufficient exit rights for minority shareholders.

In the light of the analysis above, I now turn to a brief discussion of the political dynamic for developing EU takeover regulation. As mentioned earlier, the introduction of the Takeover Directive was heavily contested, and the final directive was a compromise that upheld the status quo in many respects. It also reflected the interests of strong interested parties, including controlling shareholders, corporate management and national governments. The question thus arises as to whether there were less controversial regulatory mechanisms available for the pursuit of the relevant policies. In designing supranational legal strategies at the EU level, it is important to recognize the main concerns of the key affected constituencies and on this basis build the necessary political alliances to obtain support for regulatory initiatives. Thus, it may have been disadvantageous to introduce a break-through rule that challenged the interests of dominant constituencies in a number of EU jurisdictions. Similar policy goals and broader support could have been achieved through regulatory solutions that restricted private benefits of control and created incentives to transfer control when the existing ownership structure was sub-optimal. For example, the introduction of enhanced standards for controlling shareholders and related-party transactions may have better addressed the regulatory concerns underlying the Takeover Directive.

In conclusion, a strong case can be made that in order to regulate change of control transactions and takeovers in Europe it is insufficient to focus on EU-level takeover regulation alone. In fact, it is equally important, if not more so, to continue to develop corporate governance regulation to facilitate change of control transactions where incumbent ownership structures have become inefficient. The Takeover Directive seems to have been a bold attempt to short-circuit entrenched governance structures. The lesson may be that in developing EU regulation there are no short cuts.

CHAPTER 8

CONCLUSIONS: NORDIC PERSPECTIVES ON EU CORPORATE GOVERNANCE REGULATION

I. CHALLENGES OF EU CORPORATE GOVERNANCE REGULATION

This study has originated from observations regarding the relationship between EU corporate law and the Nordic corporate environment. EU corporate regulation has at times been ill-adapted to the Nordic corporate environment and, in particular, to governance structures based on concentrated ownership[1]. Mechanisms introduced at the EU level have been seen to challenge premises on which Nordic models of corporate governance have been based[2]. From a Nordic perspective, the break-through rule in the Takeover Directive[3] and the One-Share-One-Vote initiative[4] were deemed controversial initiatives[5], while the regulation of related party transactions in the proposal to amend the Shareholders' Rights Directive[6] has raised concern more recently[7]. These initiatives have been seen to undermine regionally prevalent corporate governance systems[8]. The effects of EU regulatory initiatives have varied depending on the relevant corporate environment[9]. Insufficient attention seems to be given to the choice of legal strategies and regulatory design for regulatory initiatives to be adapted to different corporate environments. These EU regulatory initiatives have also met with significant resistance and have been subject to considerable political compromise or have failed altogether[10]. Political resistance – to some considerable extent – has been based on regional differences in corporate governance systems[11]. The political dynamic was not sufficiently considered or taken into account in the design of regulatory mechanisms when new EU instruments have been introduced.

---

[1] *See* Jesper Lau Hansen, *The Nordic Corporate Governance Model – a European Model?*, *in* PERSPECTIVES IN COMPANY LAW AND FINANCIAL REGULATION 145 (Michel Tison, Hans de Wulf, Christoph van der Elst & Reinhard Steennot, eds. 2009).

[2] *Id*.

[3] Directive 25/2004/EC of the European Parliament and of the Council of 21 April 2004 on Takeover Bids, 2004 O.J. (L142) [hereinafter Takeover Directive].

[4] *See* Commission of the European Communities, *Impact Assessment of the Proportionality Between Capital and Control in Listed Companies*, Commission Staff Working Document SEC(2007) 1705 (2007), *available at* http://ec.europa.eu/internal_market/company/docs/shareholders/impact_assessment_122007.pdf.

[5] *See* Rolf Skog, *The Takeover Directive – an Endless Saga?*, 13 EUROPEAN BUSINESS L. REV. 301 (2002).

[6] *Proposal for a Directive of the European Parliament and of the Council Amending Directive 2007/36/EC as Regards the Encouragement of Long-term Shareholder Engagement and Directive 2013/34/EU as Regards Certain Elements of the Corporate Governance Statement*, 9.4.2014, COM(2014) 213 final, 2014/0121 (COD), [hereinafter SHRD II].

[7] *See* Klaus Hopt, *Corporate Governance in Europe – A Critical Review of the European Commission's Initiatives on Corporate Law and Corporate Governance*, 12 N.Y.U. J.L. & BUS. 139 (2015).

[8] *Id.* at 144.

[9] Marc Goergen, Martina Martynova & Luc Renneboog, *Corporate Governance Convergence: Evidence from Takeover Regulation*, 29 (ECGI Working Paper 33, 2005), *available at* http://ssrn.com/abstract=709023.

[10] *See* Luca Enriques, *Company Law Harmonization Reconsidered: What Role for the EC* (ECGI Law Working Paper No 53/2005), *available at* http://ssrn.com/abstract=850005.

[11] *See* Helen Callaghan & Martin Höpner, *European Integration and the Clash of Capitalisms: Political Cleavages over Takeover Liberalization*, 3 COMPARATIVE EUROPEAN POLITICS 307 (2005), and SIMON HIX & BJÖRN HOYLAND, THE POLITICAL SYSTEM OF THE EUROPEAN UNION, 3RD ED., 214-216 (2011).

At the same time the importance of EU regulation is increasing and the scope for national corporate regulation for listed companies has narrowed as regulatory initiatives have been concentrating to supranational forums[12]. In fact, EU corporate law has been said to have faced a revival[13], being a key field for legal harmonization and Europeanization. It is thus important to focus on developing the quality of these regulatory initiatives. Moreover, with ever-increasing internationalization it is no longer feasible to limit corporate governance and corporate regulation to the national level. Finally, the case for regulatory competition in the field of corporate governance regulation may not be as strong as assumed[14], and national level regulation may be vulnerable to entrenched interests[15]. It is thus certainly warranted to seek to develop EU corporate governance regulation. It has become apparent that it is important to develop a broader understanding of the premises of how EU regulation is designed and structured. It has also become apparent that the political aspects of corporate governance should not be underestimated and must better be taken into account in regulatory design.

II. ANSWERS TO THE RESEARCH QUESTIONS

The study set out to provide a basis for developing legal strategies for EU corporate governance regulation considering the (i) varied regulatory requirements of different corporate environments in the EU and (ii) the political dynamics of supranational corporate governance regulation.

The study first posed the question what institutional factors are relevant with respect to the effects of corporate governance regulation and how these can be taken into account in legal strategies at the supranational level. The Nordic perspective was used as a tool to identify institutional differences in the EU. The study has first incorporated a political perspective on corporate governance into the framework for analyzing the relationships between key corporate constituencies. Corporate governance indices have then been analyzed in the context of the Nordic environment and the study has established a framework for an index that incorporates elements related to the political economy and thus enhances the relevance of the index. The study has highlighted the need to understand corporate governance in the context of the relevant institutional environment. Corporate governance mechanisms cannot be analysed or compared in isolation from the broader corporate environment, including (i) the type of ownership model that is prevalent (dispersed or concentrated), (ii) the development of complementary institutions for addressing corporate governance concerns in each type of ownership system, (iii) the quality and availability of legal institutions (such as courts and agencies) and (iv) the relevant industrial, economic and political structures. These factors provide significant challenges for introducing supranational regulation. However, this does not necessarily mean that supranational solutions are sub-optimal *per se*, but that more work is needed to analyse the effects of different legal strategies at the supranational level. The EU framework provides for mechanisms that can be used to alleviate these challenges,

---

[12] *See* FINANCIAL REGULATION AND SUPERVISION, A POST-CRISIS ANALYSIS (Guido Ferrarini, Klaus Hopt & Eddy Wymeersch, eds., 2012), THE REGULATORY AFTERMATH OF THE GLOBAL FINANCIAL CRISIS (Elis Ferran, Jane Hill & John Coffee, eds., 2012), UNCTAD, Corporate Governance in the Wake of the Financial Crisis, Selected international Views (UNCTAD/DIAE/ED/2010/2), 2010.

[13] *See* John Armour & Wolf-Georg Ringe, *European Company Law 1999-2010: Renaissance and Crisis*, 48 COMM. MKT. L. REV. 125 (2011), Hopt (2015), *supra* note 7, at 144.

[14] ANDREW JOHNSTON, EC REGULATION OF CORPORATE GOVERNANCE, 177, 182 and 212-213 (2009).

[15] *See* Guido Ferrarini & Geoffrey P. Miller, *A Simple Theory of Takeover Regulation in the United States and Europe* 15 (New York University Law and Economics Working Paper 197, 2009), *available at* http://lsr.nellco.org/nyu_lewp/197.

but further efforts are needed to develop legal strategies at the EU level that are more effective and better adapted to the EU environment.

The study has also discussed the dynamics of corporate governance regulation at the EU level. The study has sought to identify the prerequisites for developing legal strategies at the EU level that would better take into consideration the differing institutional landscape and the relevant political framework in the EU. First, the study argues that the framework for the "market for regulation" includes both national and supranational levels with both private and public actors, including corporate interest groups (representatives of controlling shareholders, management, investors and labor), as well as political agendas not directly related to policies on corporations and enterprise (i.e. political salience)[16]. In this policy area the EU can certainly be seen as a multilevel system of governance[17]. Second, the study has also emphasized the impact of the institutional structures of the EU, which may affect the bargaining powers of affected constituencies and favour market-based outcomes[18]. However, as a political system the EU remains vulnerable to high-salience issues especially in the aftermath of financial crisis.The study finds that the institutional structures at the EU level are evolving, as is the role of the EU[19], with regard to pursuing regulatory policies in relation to corporate governance.

The study focuses on what the implications of these findings are for the development of legal strategies at the EU level, and what the prerequisites are for the characteristics and the challenges of this environment to be taken into account in the development and design of relevant legal strategies. The study finds that the choice of legal strategies and the design of regulatory instruments at the EU level has not been satisfactory. The unwarranted effects of EU regulation and the considerable political resistance to a number of initiatives supports these conclusions. The institutional and political dimensions of corporate governance have not sufficiently been taken into account in the choice of legal strategies and in the design of regulatory mechanisms at the EU level. Moreover, the theoretical basis for developing EU corporate governance regulation has been insufficient in this regard – and is based in part on the lack of combining different approaches to corporate governance (including combining legal and political approaches). This has resulted in (i) an incomplete understanding of the basis for corporate governance regulation, (ii) increased political resistance to regulatory initiatives due to poor choice of legal strategies, and (iii) unintended consequences of EU regulatory intervention.

The study argues that it would be possible to introduce EU level regulation that is better adapted to the varied corporate environments, and that would reflect the (political) concerns

---

16 *See* POLICY-MAKING IN THE EUROPEAN UNION, 6TH ED. (Helen Wallace, Mark A. Pollack & Alasdair R. Young, eds., 2010).

17 *See* LIESBET HOOGHE & GARY MARKS, MULTI-LEVEL GOVERNANCE AND EUROPEAN INTEGRATION (2000); Mark A. Pollack, *Theorizing EU Policy-Making*, *in* Wallace, Pollack & Young, eds. (2010), *supra* note 16, at 36-37.

18 *See* Bastiaan van Apeldoorn & Laura Horn, *The Transformation of Corporate Governance Regulation in the EU – From Harmonization to Marketization*, *in* THE TRANSNATIONAL POLITICS OF CORPORATE GOVERNANCE REGULATION (Henk Overbeek, Bastiaan van Apeldoorn & Andreas Nölke, eds., 2007), and LAURA HORN, REGULATING CORPORATE GOVERNANCE IN THE EU: TOWARDS A MARKETIZATION OF CORPORATE CONTROL (2011).

19 *See* Giandomenico Majone, *The Future of Regulation in Europe, in* REGULATING EUROPE, 265 (Giandomenico Majone, ed., 1996), Knud Erik Jorgensen, *Overview: The European Union and the World, in* HANDBOOK OF EUROPEAN UNION POLITICS 507 (Knud Erik Jorgensen, Mark A. Pollack & Ben Rosamond, eds., 2007, and NEILL NUGENT, THE GOVERNMENT AND POLITICS OF THE EUROPEAN UNION, 7TH ED. 445 (2010).

of key constituencies while still in line with relevant corporate governance policies. In connection with legislative initiatives more analysis is needed on the policy environment and its characteristics, as well as on the interactions between actors in the relevant policy area. The EU toolbox provides for a variety of legal strategies and regulatory mechanisms that can be used to adapt to different institutional landscapes. Analysis and research to be conducted in connection with EU regulatory initiatives and in connection with corporate governance regulation more generally can be developed further. Formal qualitative models[20] can be developed to incorporate the institutional and political dimensions of corporate governance in the process of developing EU corporate governance regulation.

III. CONCENTRATED OWNERSHIP AND DEFINING CORPORATE GOVERNANCE

The study has focused on corporate governance in the context of concentrated ownership. This has proved to be an interesting and somewhat neglected field of research. Concentrated ownership has provided a competitive basis for the pursuit of business enterprise[21]. Indeed, concentrated ownership has allowed for significant entrepreneurial endeavours and can be seen in some of the most successful corporations in the world. Concentrated ownership cannot be seen as an anomaly – but as a governance outcome reflecting the requirements of the corporate environment[22]. The purpose of control is not necessarily to extract private benefits of control but to provide a stable structure of corporate ownership in a given institutional environment[23].

Approaching corporate governance from this perspective has been useful for emphasizing the entrepreneurial aspects of business enterprise and the dynamics of agency relationships among corporate constituencies[24]. Entrepreneurs bargain with investors over the terms of corporate finance[25]. The basic elements of bargaining are different bundles of economic instruments allowing for different cash-flow and control rights. The financial structure of the firm represents the outcome of the bargain. Concentrated ownership can be seen as one such outcome. This perspective has also emphasized the characteristics of control of the corporation. Control rights are one element of bargaining and can be balanced against cash-flow rights, for example. Control rights may be a vital element for an entrepreneur to be able to pursue the business enterprise, and in a given institutional environment the outcome is concentrated ownership. Further development of corporate governance mechanisms that are better adapted to this environment provides for interesting research opportunities in further developing functional approaches to regulation[26].

---

[20] ELINOR OSTROM, UNDERSTANDING INSTITUTIONAL DIVERSITY, 7-15 (2005); *see also* Elinor Ostrom, *Background on the Institutional Analysis and Development Framework*, 39 Policy Studies J. 7 (2011).
[21] *See* Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARVARD L. R. 1641 (2006).
[22] *See* Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision,* 125 YALE L.J. 560 (2013).
[23] *Id.*
[24] *Id.* at 6; *see also* Oliver Hart & John Moore, *Property Rights and the Nature of the Firm*, 98 J. OF POL. ECON. 1119 (1990).
[25] *See* Oliver Hart, *Financial Contracting* (NBER Working Paper 8285, 2001) *available at* http://www.nber.org/papers/w8285.
[26] *See* Ronald Gilson, *Globalizing Corporate Governance: Convergence of Form or Function, in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 128 (Jeffrey N. Gordon & Mark J. Roe, eds., 2004).

IV. THE NORDIC PERSPECTIVE

Based on experiences from applying EU based corporate governance initiatives in the Nordic environment, it is relevant to ask what policies should be pursued with regard to EU corporate governance regulation from a Nordic perspective.

There has been some concern that the quality of the Nordic model of corporate governance has not been sufficiently recognised in established international corporate governance indices and in the international corporate governance debate[27]. The corporate governance frameworks in the Nordics have, in fact, provided a competitive base for corporate enterprise[28]. Empirical research supports the notion that Nordic corporate governance systems have not supported the extraction of significant private benefits of control, for example[29]. Yet, as economies become increasingly international and cross-border integration continues these frameworks cannot be developed in isolation from the broader environment. It can also be recognized that corporate governance outcomes in the Nordic region are not the result of unique insights, but instead remain subject to the general laws and dynamics related to the political economy[30]. Governance systems, including national systems of corporate governance, are vulnerable to capture and entrenchment – so also in the Nordics – and the premises for effective regulatory competition with regard to corporate governance may not be available in the EU[31].

The EU has become, and is likely to remain, an important source of corporate governance regulation. With the evolution of the EU "regulatory state"[32] and the internationalization of legislative initiatives it is legitimate to expect the EU to continue to have a central role in developing corporate law. Positive integration is likely to continue and to interact with negative integration measures. In fact, regardless of what position one takes on the desirability of further EU initiatives on corporate governance, it is important to analyse and develop EU legal strategies in this field. It is important to seek to develop EU regulation, and related Nordic policies, to promote EU regulation that does not challenge the basic premises of the Nordic corporate governance models. In fact, for the Nordic countries, as small export driven economies, the EU can provide an avenue to circumvent potential nationally entrenched structures. However, at the same time, there is an inherent risk of EU solutions not being adapted to the Nordic corporate environment.

Based on these premises, one can assess the need for further development of EU corporate governance regulation from a Nordic perspective.

First, based on comparative institutional analysis, the prerequisites for diverse corporate governance solutions should be maintained in the EU. Corporate governance regulation

[27] *See* Evis Sinani, Anna Stafsudd, Steen Thomsen, Christopher Edling & Trond Randoy, *Corporate Governance in Scandinavia: Comparing Networks and Formal Institutions*, 5 EUROPEAN MANAGEMENT REV. 27 (2008).
[28] *See* Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARVARD L. R. 1641 (2006).
[29] Tatiana Nenova, *The value of corporate voting rights and control: A cross-country analysis*, 68 J. OF FIN. ECON. 325, 327 and 340 (2003).
[30] PETER GOUREVITCH & JAMES SHINN, POLITICAL POWER AND CORPORATE CONTROL 140-148 (2005), and Enrico Perotti & Ernst-Ludwig von Thadden*, The Political Economy of Dominant Investors* 1 (Tinbergen Institute Discussion Paper TI 2004-091/2, 2004), *available at* http://www.haas.berkeley.edu/groups/finance/June041.pdf.
[31] *Supra* note 14.
[32] *See* Helen Wallace, *An Institutional Anatomy and Five Policy Modes, in* POLICY-MAKING IN THE EUROPEAN UNION, 6TH ED., *supra* note 16, at 69.

introduced at the EU level should not undermine the premises of different corporate governance models, including the complementary institutions that support these models. For example, where control rights are a key element for corporate governance, regulatory mechanisms that do not challenge these rights should be prioritized (i.e. transparency, fiduciary duties or reversed burden of proof instead of minority veto-rights).

At the same time, the potential for abuse should be addressed with mechanisms that are relevant and effective in the context of the applicable institutional environment. Legal strategies may need to be enhanced to be effective – especially at the EU level where only a limited selection of regulatory instruments is available and where enforcement relies heavily of national institutions, the characteristics and quality of which can vary greatly among the member states[33]. For example, to be effective, the protection of minority protection mechanisms may require the availability of qualified supervisory authorities or special legal institutions (class actions or special tribunals, for example)[34]. In this regard, the Nordic corporate governance models can still be developed further, and EU initiatives focusing on efficient enforcement may be warranted.

The corporate environment will continue to change and corporations should be able to effectively adapt to these changes[35]. Corporate governance regulation should facilitate this process by providing mechanisms that allow corporate constituencies to negotiate the terms of these changes without the risk of significant abuse. With regard to concentrated ownership environments this relates to exit rights and cash-flow rights in the context of change of control, for example. There is need for a more comprehensive analysis of corporate environments and relevant regulation affecting corporate constituencies – beyond traditional corporate governance regulation.

The dynamics of EU policy-making must be paid attention to when considering EU corporate governance policy. It can be noted that certain EU initiatives have directly challenged Nordic models of corporate governance while models used in other, perhaps more dominant EU regions, have been exempted. The one-share-one-vote initiative, for example, would have directly challenged the dual class system used in the Nordics[36]. Also, the break-through rule in the Takeover Directive, targeted control enhancing mechanisms used in the Nordics while explicitly exempting the French system of vesting more voting rights in shares held by the same shareholder for a longer duration[37]. An emphasis on a functional perspective and a focus on regulatory goals rather than specific mechanisms would allow for the introduction of regulatory mechanisms better adapted to the applicable institutional environment.

The proposed amendments to the Shareholders' Rights Directive can be considered from the same perspective. To the extent that transparency is increased with respect to related party transactions, for example, the EU initiatives can be deemed to promote investor protection in

---

[33] *See* EU Commission, Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States, 23 September 2009, *available at* http://ec.europa.eu/internal_market/company/docs/ecgforum/studies/comply-or-explain-090923_en.pdf.
[34] *See* Roland Gilson, *The Nordic Model in an International Perspective*, *in* THE NORDIC CORPORATE GOVERNANCE MODEL 94, 103 (Per Lekvall, ed., 2014).
[35] Ronald Gilson, *The Political Ecology of Takeovers: Thoughts On Harmonizing the European Corporate Governance Environment*, 61 FORDHAM L. REV. 161, 174-175 (1992).
[36] *See* Skog (2003), *supra* note 5.
[37] Ulf Bernitz, *Mechanisms of Ownership Control and the Issue of Disproportionate Distribution of Power in* COMPANY LAW AND ECONOMIC PROTECTIONISM 191, 194 (Ulf Bernitz & Wolf-Georg Ringe, eds., 2010).

the Nordic environment, where disclosure of related party transactions has not been as detailed as now proposed. However, requirements on shareholder approval of related party transactions would clearly undermine concentrated ownership interests and allow for opportunistic behaviour by minority shareholders with diversified holdings and different risk profiles. In the context of concentrated ownership, different regulatory mechanisms, such as disclosure, enhanced liability, or third party trusteeship arrangements would be better suited for these purposes.

Overall, the current regulatory goals at the EU level, as such, may be less problematic from a Nordic perspective. The goals identified in the 2012 Company Law Action Plan, for example, included ways of (i) enhancing transparency, (ii) engaging shareholders and (iii) supporting companies' growth and competitiveness especially with regard to enhancing cross-border business[38]. While these goals are general in nature they would not, as such, conflict with Nordic corporate governance. However, from a Nordic perspective, some further goals for EU corporate governance regulation could be added, including (i) applying a functional approach to EU regulation that does not disenfranchise or undermine different forms of corporate governance, and (ii) facilitating the ability of businesses to adapt to a changing business environment.

V. Further Research

Much work is needed to develop regulatory approaches to meet the requirements of an ever more internationalized environment. Defining regulation and legal systems in purely national terms is certainly outdated, while the basis for regional political and regulatory systems is still very much in the developing phase. Challenges related to the development of regulation that is applied to huge and diverse regions and issued through fairly new political systems, such as the EU, will of course be more profound than at the national level, which has largely served as an institutional basis for regulation for the past centuries. Further research on EU legislative processes and on the effects of EU regulation is certainly called for.

This study has focused on creating a framework for understanding the interaction among regulation, politics and institutional structures. This framework can be tested and built on by empirical and analytical means to gain more insight into the dynamics of EU corporate governance regulation as well as the dynamics of regulation in multilevel environments more generally. The individual chapters in this study can form a basis for further empirical and analytical studies.

Corporate Governance Indices

Empirical studies can be used to develop the framework for a Nordic corporate governance index established in the chapter *"Towards a Nordic Corporate Governance Index – Metrics for Concentrated Ownership"*. The framework can be tested and further developed with respect to the relative weight of different mechanisms in different corporate environments. Further jurisdictions can be added to test the framework and its robustness. The results can then be compared with other corporate governance indexes and it can be analysed whether the framework provides for more accurate metrics.

---

[38] *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Action Plan: European Company Law and Corporate Governance – a Modern Legal Framework for More Engaged Shareholders and Sustainable Companies*, COM(2012) 740/2.

Qualitative Models for EU Policy-Making

The approaches developed in the chapters on the law and politics of the EU company law action plan (*"The Law and Politics of the EU Company Law Action Plan – Towards a federal System of Corporate Governance Regulation in the EU?"*) and on the law and politics of supranational regulation (*"Law and Politics of Supranational Regulation: Dynamics of EU Corporate Governance Regulation"*) can be used to analyse pending or very recent corporate governance initiatives – specifically the proposed amendments to the Shareholders' Rights Directive. The amendments provide a potentially interesting reflection on the dynamics among relevant corporate interest groups in the framework of EU corporate governance regulation in the current political climate with an active Commission. The approaches developed in the chapters can be built on through qualitative methods, including interviews, in relation to the legislative process underlying the proposed amendments.

Comparative Institutional Analysis in the EU

The EU has launched projects with the aim of better regulation[39]. The EU efforts for better regulation may have been driven by populist policy, as sentiment among electorates has been negative towards EU regulation that has been deemed overly burdensome and technically complex[40]. Yet serious efforts to develop EU regulation are clearly warranted.

A key factor in developing EU level regulation is increasing knowledge of regulatory environments and solutions adopted in the EU member states. This study suggests that further comparative analysis of different corporate governance models in the EU is important and useful for developing appropriate regulation. In this analysis corporate governance must be understood broadly. The factors affecting corporate enterprise and the relative positions of key corporate constituencies are not limited to the relevant provisions of national company law, but includes the broader regulatory and institutional environment. Relevant factors include the prevalent industrial structures and the prevalent structures of corporate ownership, effects of taxation, the quality of legal institutions (courts and agencies), the structure of the political system, and the dynamics of political coordination.

Projects to outline and compare corporate law systems in the EU in a more comprehensive manner would be called for in order to gain insights for developing EU level legal strategies. An important effort to develop corporate regulation at the EU level has been the EU model company law project[41]. This initiative is useful and could be broadened to include more comprehensive analysis of the background of different regulatory solutions (in their respective institutional environments). However, the goal of the project does not have to be the introduction of a uniform company law or even a model code. In fact, it has been proposed that such comprehensive uniform rules may be counterproductive[42]. However, this exercise provides the framework for a comprehensive comparative discussion and analysis of national company laws in the EU, and increases our understanding of the variety of the

[39] *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Better Regulation for Better Results - An EU Agenda*, COM(2015) 215 final, Strasbourg, 19.5.2015.
[40] *Id.*
[41] See Theodor Baums & Paul Kruger Andersen, *The European Model Company Act Project in* PERSPECTIVES IN COMPANY LAW AND FINANCIAL REGULATION, *supra* note 1, at 5; *see also* Introduction to the Final European Model Company Act, September 2015, *available at* http://law.au.dk/en/research/projects/european-model-company-act-emca/.
[42] Hopt (2015), *supra* note 7, at 211-212.

institutional environments affecting corporate enterprise. Indeed, the scope of the comparative exercise should be broadened so as to provide a more comprehensive analysis of the relationship between corporate governance environments and corporate law in the EU member states. This would provide a better basis for EU policy-making in the field of corporate governance and company law in general.

Corporate Theories – from Agency Theory to Financial Contracting and Game Theory

Finally, it seems that further research is also warranted with respect to general corporate theory. Corporate governance theories may well have been influenced by existing industrial and political structures, and have proved insufficient when these structures evolve. An emphasis on the institutional context of corporate governance and on the incomplete nature of contracting provide the basis for pursuing more general premises for corporate governance. Theories on corporate governance related to the application of game theoretical approaches in institutional settings can provide a more nuanced basis for understanding the relationships among corporate constituencies[43]. Importantly, these approaches provide a basis that also takes corporate performance and efficiency into consideration, while allowing for the inclusion of political realities and dynamics into the realm of corporate governance. In this respect, the application of comparative institutional analysis to specific corporate governance environments in the EU has provided a promising field of comparative corporate governance research[44].

[43] See MASAHIKO AOKI, THE CO-OPERATIVE GAME THEORY OF THE FIRM (1984).
[44] *See* MASAHIKO AOKI, TOWARD A COMPARATIVE INSTITUTIONAL ANALYSIS 280-305 (2001).

BIBLIOGRAPHY

BIBLIOGRAPHY

BOOKS

Aktiemarknadsnämnden, Aktiemarknadsnämnden 25 år – en antologi [the Swedish Securities Council 25 Years – an Anthology] (2011)

Aoki, Masahiko, The Co-operative Game Theory of the Firm (1984)

Aoki, Masahiko, Toward a Comparative Institutional Analysis (2001)

Aoki, Masahiko, Corporations in Emerging Diversity: Cognition, Governance and Institutions (2010)

Aoki, Masahiko, Corporations in Evolving Diversity (2010)

Armour, John & McCahery, J.A., (eds.), After Enron: Improving Corporate Law and Modernizing Securities Markets (2006)

Barca, Fabrizio & Becht Marco (eds.), The Control of Corporate Europe (2001)

Barker, Roger M., Corporate Governance, Competition and Political Parties, Explaining Corporate Governance Changes in Europe (2010)

Becker, Uwe, (ed.), The Changing Political Economies of Small West European Countries (2011)

Belcredi, Massimo & Ferrarini, Guido, (eds.), Boards and Shareholders in European Listed Companies (2013)

Bergström, Clas & Samuelsson, Per, Aktiebolagets Grundproblem [Basic Problems of the Stock Company] (4th ed. 2013)

Bernitz, Ulf & Ringe, Wolf-Georg (eds.), Company Law and Economic Protectionism: New Challenges for European Integration (2010)

Blair, Margaret M., Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century (1995)

Coase, Ronald, The Firm, The Market and the Law (1988)

Culpepper, Pepper D., Quiet politics and Business Power (2011)

Dotevall, Rolf, Bolagsledningens Skadeståndsansvar [The Liability of Corporate Management] (2nd ed. 2008)

Feldstein, Martin & Siebert, Horst (eds.), Social Security Pension Reform in Europe (2002)

Fellman, Susanna, Iversen, Martin Jes, Hans, Sjögren & Thue, Lars, (eds.) Creating Nordic Capitalism (2008)

Ferran, Elis, Hill, Jane & Coffee, John, (eds), The Regulatory Aftermath of the Global Financial Crisis (2012)

Ferrarini, Guido, Hopt, Klaus, Jaap, Winter & Wymeersch, Eddy, (eds.), Reforming Company and Takeover Law In Europe (2004)

Ferrarini, Guido, Hopt, Klaus & Wymeersch, Eddy, (eds.), Financial Regulation and Supervision, A Post-Crisis Analysis (2012)

Gordon, Jeffrey N. & Roe, Mark J., (eds.) Convergence and Persistence in Corporate Governance (2004)

Gourevitch, Peter A. & Shinn, James, Political Power & Corporate Control – The New Global Politics Of Corporate Governance (2005)

Grant, J, (ed.), European Takeovers: The Art of Acquisition (2005)

Hall, Peter A. & Soskice, David (eds.), Varieties of Capitalism: The Institutional Foundations of Comparative Advantage (2001)

Hancké, Bob (ed.), Debating Varieties of Capitalism (2009)

Hansen, Jesper Lau, Nordic Company Law – The Regulation of Public Companies in Denmark, Finland, Norway and Sweden (2003)

Hart, Oliver, Firms, Contracts and Financial Structure (1995)

Hix, Simon and Höyland, Björn, The Political System Of The European Union (2011)

Hollo, Erkki J. (ed.), Studies on the Finnish Legal System (2011)

Hooghe, Liesbet & Marks, Gary, Multi-Level Governance and European Integration, (2000)

Horn, Laura, Regulating Corporate Governance In The EU: Towards A Marketization Of Corporate Control (2011)

Hopt, Klaus & Wymeersch, Eddy (eds.), Capital Markets and Company Law (2003)

Huizinga, Harry & Jonung, Lars, (eds.), The Internationalization of Asset Ownership in Europe (2005)

Hyytinen, Ari & Pajarinen, Mika, (eds.) Financial Systems and Firm Performance, Theoretical and Empirical Perspectives (2003)

Hyvärinen, Anna, Suomen Mahdollisuudet Vaikuttaa Euroopan Unionin Lainsäädäntömenettelyyn [Finland's Possibilities to Exert Influence in EU-Law Making] (2015)

Johnston, Andrew, Ec Regulation of Corporate Governance (2009)

Jorgensen, Knud Erik, Pollack, Mark A. & Rosamond, Ben (eds.), Handbook of European Union Politics, (2007)

Kaisanlahti, Timo, Sidosryhmät ja riski pörssiyhtiössä [Interest Groups and Risk in the Listed Company] (1998)

Kingdon, John W., Agendas, Alternatives and Public Choices (1984)

Kraakman, Reinier, et al., The Anatomy Of Corporate Law (2nd. ed., 2009)

Kyläkallio, Juhani, Iirola, Olli & Kyläkallio, Kalle, Osakeyhtiö [The Stock Company], (5th ed. 2012)

Lekvall, Per, (ed.), The Nordic Corporate Governance Model (2014)

Majone, Giandomenico, (ed.), Regulating Europe (1996)

Marciano, Alain & Josselin, Jean-Michel, (eds.), The Economics of Harmonizing European Law, (2002)

McCann, Dermot, The Political Economy Of the European Union (2010)

Miller, Russell & Zumbansen, Peer, Annual Review of German and European Law, Volume I (2003)

Morck, Randall K.,(ed.), A History of Corporate Governance Around the World: Family Business Groups to Professional Managers (2005)

Nachemson-Ekwall, Sophie, An Institutional Analysis of Cross-Border Hostile Takeovers (2012).

North, Douglass C., Institutions, Institutional Change and Economic Performance (1990)

Nugent, Neill, The Government and Politics of the European Union, (7th ed. 2010)

Ogus, Anthony I., Regulation, Legal Form and Economic Theory (1994)

Olson, Mancur, The Logic of Collective Action (2nd Ed., 1971)

Ostrom, Elinor, Understanding Institutional Diversity, (2005)

Overbeek, Henk, van Apeldoorn, Bastiaan & Nölke, Andreas, (eds.), The Transnational Politics of Corporate

Pacces, Alessio M., Rethinking Corporate Governance – The Law and Economics of Control Powers (2012)

Posner, Richard A., Economic analysis of law (1998)

Randall, K. Morck (ed.), A History of Corporate Governance around the World: Family Business Groups to Professional Managers (2005)

Roe, Mark J., Strong Managers, Weak Owners, The Political Roots of American Corporate Finance (1996)

Roe, Mark, The Political Determinants of Corporate Governance: Political Context, Corporate Impact (2003)

Roumeen, Islam (ed.), The Right to Tell: The Role of Media in development (2002)

Sandholtz, Wayne & Sweet, Alec Stone, European Integration and Supranational Governance (1998)

Sjåfjell, Beate, Towards a Sustainable European Company Law (2009)

Stattin, Daniel, Takeover (2009)

Timonen, Pekka, Määräysvalta, Hinta ja Markkinavoima [Control, Price and Market Power] (1997)

Tison Michel, de Wulf, Hans, van der Elst, Christoph & Steennot, Reinhard, (eds.) Perspectives in Company Law and Financial Regulation (2009)

Vahtera, Veikko, Osakeomistuksen Riski ja Sääntely [The Risks and Regulation of Share Ownership] (2011)

Vives, Xavier (ed.), Corporate Governance: Theoretical and Empirical Perspectives (2000)

Wallace, Helen, Pollack, Mark A. & Young, Alasdair R., (eds.) Policy-Making in the European Union, (6th ed. 2010)

Weiss, Christian, *The Ownership Concentration of Firms: Three Essays on the Determinants and Effects* 133 (Dissertation, European Business School, International University Schloss Reichanthausen, 2010)

Williamson, Oliver, The Economic Institutions of Capitalism (1985)

Wilson, James Q., The Politics of Regulation (1980)

JOURNAL ARTICLES AND WORKING PAPERS

Achleitner, Ann-Kristin, Betzer, André, Goergen, Marc & Hinterramskogler, Bastian, *Private Equity Acquisition of Continental European Firms - The Impact of Ownership and Control on the Likelihood on Being Taken Private* (Working paper, June 2010)

Aghion, Philippe & Bolton, Patrick, *An Incomplete Contracts Approach to Financial Contracting*, 59 R. Econ. Studies 473 (1992)

Agnblad, Jonas, , Berglöf, Erik, Högfeldt, Peter & Svancar, Helena, *Ownership and Control in Sweden: Strong Owners, Weak Minorities and Social Control,* In The Control of Corporate Europe (Barca Fabrizio & Becht, Marco, eds.) (2002)

Aguilera Ruth V., Filatotchev, Igor, Gospel Howard & Jackson Gregory, *An Organizational Approach to Comparative Corporate Governance: Costs, Contingencies, and Complementarities*, 19 Organization Science 475 (2008)

Aguilera, Ruth V. & Jackson, Gregory, *The Cross-National Diversity of Corporate Governance: Dimensions and Determinants*, 28 Academy of Management Review 447 (2003)

Aguilera, Ruth V. & Jackson, Gregory, *Comparative and International Corporate Governance*, 4 The Academy of Management Annals 485 (2010)

Aoki, Masahiko & Jackson, Gregory, *Understanding an Emergent Diversity of Corporate Governance and Organizational Architecture: An Essentiality-Based Analysis* (SIEPR Discussion Paper 07-19, 2007)

Aoki, Masahiko, *The Japanese Firm as a System of Attributes: A Survey and Research Agenda, in* the Japanese Firm: the Sources of Competitive strength (Aoki Masahiko & Dore Ronald, eds., 1994)

Aoki, Masahiko, *Towards an Economic Theory of the Japanese Firm*, 23 J.of Econ.Litt. 1 (1990)

Armour, John, *Who Should Make Corporate Law? EC Legislation versus Regulatory Competition* (ECGI - Law Working Paper No. 54/2005)

Armour, John, Deakin, Simon, Sarkar, Prabirjit, Siems, Mathias & Singh, Ajit, *Shareholder Protection and Stockmarket Development: An Empirical Test of the Legal Origins Hypothesis*, 6 J. of Empirical L. Studies, 343 (2009)

Armour, John & Ringe, Wolf-Georg, *European Company Law 1999-2010: Renaissance and Crisis* (ECGI – Law Working Paper No. 175, 2011, Oxford Legal Studies Research Paper No. 63/2010)

Armour, John & Skeel, David, *Who Writes the Rules for Hostile Takeovers, and Why? – The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 Geo.L.J. 1727 (2007).

Bainbridge, Stephen M., *Director Primacy: The Means and Ends of Corporate Governance*, 97 Nw. U. L. Rev. 547 (2002-2003)

Barontini, Roberto & Caprio, Lorenzo, *The Effect of Family Control on Firm Value and Performance, Evidence from Continental Europe* (ECGI – Finance Working Paper No. 88/2005)

Bebchuk, Lucian A., *Efficient and Inefficient Sales of Corporate Control*, 109 Quarterly Journal of Economics, 957 (1994).

Bebchuk, Lucian A., *A Rent-Protection Theory of Corporate Ownership and Control* (National Bureau of Economic Research Working Paper 7203, July 1999)

Bebchuk, Lucian A., *The Case for Shareholder Access to the Ballot*, 59 Bus.Law. 43 (2003)

Bebchuk, Lucian A., *The Case for Increasing Shareholder Power*, 118 *Harv. L. Rev*. 833 (2005)

Bebchuk, Lucian A., Cohen, Alma & Ferrell, Allen, *What Matters in Corporate Governance?* (HLS John M. Olin Center Discussion Paper 491/2005)

Bebchuk, Lucian A. & Ferrell, Allen, *A New Approach to Takeover Law and Regulatory Competition* (NBER Working Paper No. 8148, 2001)

Bebchuk, Lucian A. & Hamdani, Assaf, *Federal Corporate Law: Lessons from History* (Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series 8-5-2006, 2006)

Bebchuk, Lucian A. & Hamdani, Assaf, *The Elusive Quest for Global Governance Standards* (John M. Olin Center Discussion Paper 633, 2009)

Bebchuk, Lucian A. & Hirst, Scott, *Private Ordering and the Proxy Access Debate*, 65 BUS. LAW. 329 (2010)

Bebchuk, Lucian A., Kraakman, Reinier & Triantis, George, *Stock Pyramids, Cross-Ownership and Dual Class Equity: The Creation and Agency Costs of Separating Control from Cash Flow Rights* (Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series 249, 1999)

Bebchuk, Lucian A. & Neeman, Zvika, *Investor Protection and Interest Group Politics* (John M. Olin Center Program on Corporate Governance Discussion Paper 603, 2007)

Bebchuk, Lucian A. & Roe, Mark J., *A Theory of Path Dependence in Corporate Governance and Ownership*, 52 STAN. L. REV. 127 (1999)

Bebchuk, Lucian A. & Weisbach, Michael S., *The State of Corporate Governance Research*, 23 Rev. of Fin. St. 939 (2010)

Becker, Gary, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Quarterly J. of Econ. 371 (1983)

Becht, Marco, *Reciprocity in Takeovers* (ECGI – Law Working Paper No. 14/2003)

Becht Marco, Bolton Patrick & Röell Ailsa, *Corporate Governance and Control* (ECGI Finance Working Paper No 02, 2002, updated as of August 2005)

Belloc, Marianna & Pagano, Ugo, *Co-Evolution of Politics and Corporate Governance*, 29 INT'L. R. OF LAW AND ECON. 106 (2009)

Belloc, Marianna & Pagano, Ugo, *Politics-Business Co-Evolution Paths: Workers' Organization and Capitalist Concentration*, 33 Int.l. Rev. of L. and Econ. 23 (2013)

Bennedsen, Morten & Nielsen, Kaspar, *The Impact of the Break-Through Rule on European Firms*, 17 Europ. J. of Law and Econ. 259 (2004)

Bennedsen, Morten & Nielsen, Kasper, *The Principle of Proportionality: Separating the Impact of Dual Class Shares, Pyramids and Cross-Ownership on Firm Value Across Legal Regimes in Western Europe* (Center for Industrial Economics Discussion Papers, University of Copenhagen, 2005)

Berglöf, Erik, & Burkart, Mark, *European Takeover Regulation*, 18 Economic Policy 171 (2003)

Bhagat, Sanjai et al*., The Promise and Peril of Corporate Governance Indices*, 108 COLUM. L. REV. 1803 (2008).

Blair, Margaret M. & Stout, Lynn A., *A Team Production Theory of Corporate Law*, 85 Virginia L.R. 247 (1999)

Blair, Margareth & Stout, Lynn, *Specific Investment and Corporate Law*, 7 *European Business Organization L.R.* 495 (2006)

Bohren, Oyvind & Odegaard, Bernt Arne, *Corporate Governance and Economic Performance in Norwegian Listed Companies* (Norwegian School of Management Working Paper, 2001)

Boot, Arnoud W. A., Gopalan, Radhakrishnan & Thakor, Anjan V., *The Entrepreneur's Choice between Private and Public Ownership*, 61 J. OF FIN. 803 (2006)

de Búrca, Grainne, *Rethinking Law in Neofunctionalist Theory*, 12 J. of Eur. Publ. Pol. 310 (2005)

Burkart, Mike, *The Economics of Takeover Regulation* (SITE Working Paper 99/06, Stockholm School of Economics)

Burkart, Mike, Gromb, Denis & Panunzi, Fausto, *Large Shareholders, Monitoring and the Value of the Firm*, 112 Quarterly Journal of Economics 693 (1997)

Burkart, Mike Burkart & Panunzi, Fausto, *Mandatory Bids, Squeeze-out, Sell-out and the Dynamics of the Takeover Process* (ECGI Law Working paper No. 10/2003)

Callaghan, Helen, *How Multilevel Governance Affects the Clash of Capitalisms* (MPIfG Discussion Paper 08, 2005)

Callaghan, Helen & Höpner, Martin, *European Integration and the Clash of Capitalisms: Political Cleavages over Takeover Liberalization*, 3 Comparative European Politics 307 (2005)

Cheffins, Brian R., Bank, Steven A. & Wells, Harwell, *The Race to the Bottom Recalculated: Scoring Corporate Law Over Time* (ECGI Law Working Paper 261, 2014)

Cioffi, John W., *The Collapse of the European Union Directive on Corporate Takeovers: The EU, National Politics, and the Limits of Integration* (Berkeley Roundtable on the International Economy, Discussion Paper September 28, 2001)

Claessens, S., Fan, J.P.H. & Lang, L.H.P. *Disentangling the Incentive and Entrenchment Effects of Large Shareholdings*, 57 Journal of Finance 2741 (2002)

Claessens, Stijn et al, *The Separation of Ownership and Control in East Asian Corporations*, 58 JFE 81 (2000)

Claessens, Stijn, Djankov, Simeon, Fan, Joseph P.H. & Lang, Larry H.P., *The Benefits and Costs of Group Affiliation: The Evidence from East Asia* (CEPR Discussion paper 3364, 2002)

Clift, Ben, *The Second Time as Farce? The EU takeover Directive, the Clash of Capitalisms and the Hamstrung Harmonization of European (and French) Corporate Governance*, 47 JCMS 55 (2009)

Coase, Ronald, *The Nature of the Firm*, 4 ECONOMICA 386 (1937)

Coates, John C. IV, *Ownership, Takeovers and EU Law: How Contestable Should EU Corporations Be?* 12 (ECGI Law Working Paper 11, 2003)

Coffee, John C. Jr., *Do Norms Matter?: A Cross-Country Examination of the Private Benefits of Control* (Columbia Law School Center for Law and Economic Studies Working Paper No. 183, 2001)

Coffee, John C. Jr., *Understanding Enron: It's About the Gatekeepers, Stupid* (Columbia Law & Economics Working Paper No. 207, 2002)

Coffee, John C., *Unstable Coalitions: Corporate Governance as a Multi-Player Game*, 78 Geo.L.J. 1495 (1989-1990)

Cools, Sofie, *The Real Difference in Corporate Law between the United States and Continental Europe: Distribution of Powers* (Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series, Paper 490, 2004)

Dallas, Lynn, *Short-Termism, the Financial Crisis and Corporate Governance*, 37 J. CORP. L. 264 (2011)

Davies Paul, Schuster, Edmund-Philippe & Van de Walle de Ghelcke, Emilie, *The Takeover Directive as a Protectionist Tool?* (ECGI Law Working Paper 141, 2010)

Deakin, Simon, *Reflexive Governance and European Company Law* (Centre for Business Research, University of Cambridge, Working Paper No. 346, 2007

Deakin, Simon, *Regulatory Competition versus Harmonisation in European Company Law* (Centre for Business Research, University of Cambridge, Working Paper No. 163, 2000)

Deffains, Bruno & Demougin, Dominique M., *Governance: Who Controls Matters* (SFB 649 Discussion Paper No 53, 2006)

Demsetz, Harold & Lehn, Kenneth, *The Structure of Corporate Ownership: Causes and Consequences*, 93 Journal of Pol. Ec. 1155 (1985)

Demsetz, Harold & Villalonga, Belen, *Ownership Structure and Corporate Performance*, 7 Journal of Corporate Finance 209 (2001)

Djankov, Simeon, La Porta, Rafael, Lopez-de-Silanes, Florencio & Shleifer, Andrei, *The Law and Economics of Self-Dealing*, 88 J. of Fin. Econ. 430 (2008).

Dyck, Alexander & Zingales, Luigi, *Private Benefits of Control: An International Comparison*, 59 J. OF FINANCE 537 (2004)

Edström, Örjan, Involvement of Employees in Private Enterprises in Four Nordic Countries, 43 *Scandinavian Studies in Law* 159 (2002).

Edwards, Vanessa, *The Directive on Takeover Bids – Not Worth the Paper It's Written On?,* 1 ECRF 416 (2004)

Eklund, Johan E., *Corporate Governance and Investments in Scandinavia – Ownership Concentration and Dual-class Equity Structure* (CESIS Electronic Working paper Series, 2007)

van der Elst, Christoph, *Shareholder Mobility in Five European Countries* (ECGI - Law Working Paper 104/2008)

van der Elst, Christoph & Vermeulen, Erik, *Europe's Corporate Governance Green Paper: Do Institutional Investors Matter?* (Tilburg Law School Legal Studies Research Paper Series 14, 2011)

Enriques, Luca, *Company Law Harmonization Reconsidered: What Role for the EC* (ECGI Law Working Paper No 53, 2005)

Enriques, Luca, *EC Company Law Directives and Regulations: How Trivial Are They?*, 27 U.Pa.J. Int'l.Ec.L. 1 (2006)

Enriques, Luca & Gatti, Matteo, *The Uneasy Case for Top-down Company Law Harmonization in the European Union*, 27:4 U. PA. J. INT'L ECON. L. 939 (2006)

Enriques, Luca, Gilson, Ronald & Pacces, Alessio, *The Case for an Unbiased Takeover Law (With an Application to the European Union)*, 4 HARVARD BUS. L. REV. 85 (2014)

Enriques, Luca & Volpin, Paolo, *Corporate Governance Reforms in Continental Europe*, 21 J. ECON. PERSP. 117 (2007)

Faccio, Mara & Lang, Larry H.P., *The Ultimate Ownership of Western European Corporations,* 65 JFE 365, (2002)

Ferrarini, Guido & Geoffrey P. Miller, *A Simple Theory of Takeover Regulation in the United States and Europe* 15 (New York University Law and Economics Working Paper 197, 2009)

Filatotchev, Igor, Toms, Steve & Wright, Mike, *The Firm's Strategic Dynamics and Corporate Governance Life-cycle*, 2 INT'L J. OF MAN. FIN. 256 (2006)

Gelter, Martin, *The Pension System and the Rise of Shareholder Primacy* (Fordham University School of Law Working Paper Series, 2012)

Gerard, Damien M. B., *Protectionist Threats Against Cross-Border Mergers: Unexplored Avenues to Strengthen the Effectiveness of Article 21 ECMR*, 45 Common Market L.R. 987 (2008)

Giannetti, Mariassunta & Laeven, Luc, Pension Reform, Ownership Structure, and Corporate Governance: Evidence From a Natural Experiment, 22 *The Review of Financial Studies* 4091 (2009).

Gilson, Ronald, *The Political Ecology of Takeovers: Thoughts On Harmonizing the European Corporate Governance Environment*, 61 FORDHAM L. REV. 161 (1992).

Gilson, Ronald, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy,* 119 Harvard L.R. 1642 (2006).

Gilson, Ronald & Gordon, Jeffrey, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785 (2003).

Gilson, Ronald & Gordon, Jeffrey, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUMBIA L.R. 863 (2013)

Gilson, Ronald & Schwartz, Alan, *Constraints on Private Benefits of Control: Ex Ante Control Mechanisms versus Ex Post Transaction Review*, 169 JITE 160 (2012)

Goergen, Marc, Martynova, Marina & Renneboog, Luc, *Corporate Governance Convergence: Evidence from Takeover Regulation* (ECGI working paper No. 33, 2005)

Goergen, Marc, *What do We know about Different Systems of Corporate Governance* (ECGI Finance Working Paper 163, 2007)

Gompers, Paul, Ishii, Joy L. & Metrick, Andrew, *Corporate Governance and Equity Prices* (NBER Working Paper 8449, 2001)

Gordon, Jeffrey, & Roe, Mark, *Introduction, in* Convergence and Persistence in Corporate Governance

Goshen, Zohar & Hamdani, Assaf, *Corporate Control and Idiosyncratic Vision,* 125 Yale L.J. 560 (2013)

Grant, Jeremy & Kirchmaier, Thomas: *Who Governs? Corporate Ownership and Control Structures in Europe* (SSRN Working Paper, June 7, 2004)

Habbard, Pierre, *Corporate Governance in Sweden – An International Trade Union Perspective* (TUAC Report, 2008)

Hansen, Jesper Lau, *A Scandinavian Approach to Corporate Governance*, 50 Scandinavian Studies in Law 125 (2007)

Hansmann, Henry, Kraakman, Reinier & Squire, Richard, *Law and the Rise of the Firm*, 119 HARV. L. REV. 1333 (2006)

Hart, Oliver *Financial Contracting* (NBER Working Paper 8285, 2001)

Hart, Oliver & Moore, John, *Property Rights and the Nature of the Firm*, 98 J. OF POL. ECON. 1119 (1990)

Heine, Klaus & Kerber, Wolfgang, *European Corporate Laws, Regulatory Competition and Path Dependence*, 13 Eur. Jnl. Law & Econ. 47 (2002)

Henrekson, Magnus & Jakobsson, Ulf, *The Swedish Corporate Governance Model: Convergence, Persistence or Decline?* 20 Corporate Governance: An International Review 212 (2012)

Hertig, Gerard & McCahery, Joseph A., *Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition?* (ECGI Law Working Paper No. 12/2003)

Hiscox, Michael, *Class versus Industry Cleavages: Inter-Industry Factor Mobility and the Politics of Trade*, 50 International Organization 1 (2001)

Hix, Simon, Noury, Abdul & Roland, Gérard, *Voting patterns and alliance formation in the European Parliament*, 362 Phil. Trans. R. Soc. B, 821 (2009)

Holderness, Clifford, *The Myth of Diffuse Ownership in the United States*, 22 Rev. of Fin. Studies 1377 (2007)

Holmén, Martin & Högfeldt, Peter, *A Law and Finance Analysis of Initial Public Offerings*, 13 J. of Fin. Intermediation 324 (2004)

Holmén, Martin & Högfeldt, Peter, *Pyramidal Discounts: Tunneling or Agency Costs?* (ECGI Working Paper 73, 2005)

Holmén, Martin & Högfeldt, Peter, *Pyramidal Discounts, Tunneling or Overinvestment?*, 2 Int. Rev. of Fin. 133 (2009)

Holmén, Martin & Knopf, John D., *Minority Shareholder Protection and the Private Benefits of Control for Swedish Mergers*, 39 J. OF FIN. AND QUANT. ANALYSIS 167 (2004)

Hopt, Klaus, *Takeover Regulation in Europe – The Battle for the 13th Directive on Takeovers*, 15 Australian J. of Corp. L. 1 (2002)

Hopt, Klaus, *Comparative Corporate Governance: The State of the Art and International Regulation* (ECGI Working Paper No. 170, 2011)

Hopt, Klaus, *Corporate Governance in Europe – A Critical Review of the European Commission's Initiatives on Corporate Law and Corporate Governance*, 12 N.Y.U. J.L. & Bus. 139 (2015)

Horn, Laura, *Corporate Governance in Crisis? The Politics of EU Corporate Governance Regulation*, 18 European L. J. 83 (2012)

Hyytinen, Ari, Kuosa, Ilkka, ,& Takalo, Tuomas, *Law or Finance: Evidence from Finland* 30 (ETLA Discussion Paper No. 775, 2001)

Jensen, Michael & Meckling. William, *Theory of the Firm – Managerial Behavior, Agency Costs and Ownership Structure*, 3 JFE 305 (1976)

Johnson, Simon, La Porta, Rafael, Lopez de Silanes, Florencio & Shleifer, Andrei, *Tunnelling* (Harvard Institute of Economic Research Paper No. 1887, 2000)

Kahan, Marcel, *The State of State Competition for Incorporations* (ECGIW Law Working Paper 263, 2014)

Kahan, Marcel & Kamar, Ehud, *The Myth of State Competition in Corporate Law*, 55 Stan. L. Rev. 679 (2002)

Khachaturyan, Arman, *The One-Share-One-Vote Controversy in the EU*, 8 European Bus. Org. L. Rev. 335 (2007)

Korkeamäki, Timo, Koskinen, Yrjö & Takalo, Tuomas, *Phoenix Rising: Legal Reforms and Changes in Valuations in Finland During the Economic Crisis* 29 (Bank of Finland Research Discussion Papers, 2007)

Korkeamäki, Timo, Rainio, Elina & Takalo, Tuomas, *Reforming Corporate Law in an Emerging Market: The Case of Finland in the 1970's,* 21 ECONOMICS OF TRANSITION 509 (2013)

Köke, Jens*, Control Transfers in Corporate Germany: Their Frequency, Causes, and Consequences* (ZEW Discussion Paper No. 00-67, 2001)

Lang, Larry H.P. & Young, L., *Dividends and Expropriation*, 91 Am. Econ. 54 (2001)

La Porta, Rafael, Schleifer, Andrei & Vishny, Robert, *Law and Finance*, 106 J. of Pol. Ec. 1113 (1998)

La Porta, Rafael, Lopez-de-Silanes, Florencio & Schleifer, Andrei, *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999)

La Porta, Rafael, Lopez-de-Silanes, Florencio, Shleifer, Andrei & Vishny, Robert, *Investor Protection and Corporate Governance*, 58 J. of Fin. Econ. 2 (2000)

La Porta, Rafael, Lopez-de-Silanes, Florencio, Shleifer, Andrei, *The Economic Consequences of Legal Origins*, 46 J. ECON. LITERATURE 285 (2008)

Lele, Priya P. & Siems, Mathias M., *Shareholder Protection: A Leximetric Approach,* 7 Journal of Corporate Law Studies 17 (2007).

Lenoble, J. & Maesschalck, M., *Beyond Neo-Institutionalist and Pragmatist Approaches to Governance* (Reflexive Governance in the Public Interest Working Paper Series REFGOV-SGI/TNU-1, 2006)

Letza, Steve, Sun, Xiuping & Kirkbide, James, *Shareholding Versus Stakeholding: a Critical Review of Corporate Governance*, 12 Corporate Governance: An International Review, 242 (2004)

Martynova, Marina & Renneboog, Luc, *Mergers and Acquisitions in Europe* (ECGI Finance Working Paper 114, 2006)

Marina Martynova & Luc Renneboog, *A Corporate Governance Index: Convergence and Diversity of National Corporate Governance Regulations* (TILEC Working Paper 12, 2010)

McCahery, Joseph A. & Renneboog, Luc, with Ritter, Peer & Haller, Sascha, *The Economics of the Proposed European Takeover Directive* (CEPS Research Report, Finance and Banking, No. 32, April 2003)

Morck, Randall, *How to Eliminate Pyramidal Business Groups: The Double Taxation of Inter-corporate Dividends and other Incisive Uses of Tax Policy*, 19 TAX POLICY AND THE ECONOMY 135 (2005)

Mueller, Dennis C. & Yurtoglu B. Burcin, *Country Legal Environments and Corporate Investment Performance*, 1 German Economic Review 187 (2000)

Murphy, Antoin E., *Corporate Ownership in France: The Importance of History* (NBER Working Paper Series 10716, 2004)

Nenova, Tatiana, *The Value of Corporate Voting Rights and Control: A Cross-country Analysis*, 68 J. of Fin. Econ. 325 (2003)

O'Sullivan, Mary, *Corporate Governance and Globalization*, 570 Annals of the American Academy of Political and Social Science 153 (2000)

Ostrom, Elinor, *Background on the Institutional Analysis and Development Framework*, Policy Studies J. (2011)

Pacces, Alessio M., *Control Matters: Law and Economics of Private Benefits of Control* (Rotterdam Institute of Law and Economics, Working Paper 2009/04, 2009)

Pagano, Ugo, *The Evolution of the American Corporation and Global Organizational Biodiversity*, 35 Seattle U. L. R. 1271 (2012)

Pagano, Marco & Volpin, Paolo, *The Political Economy of Corporate Governance* (Centre for Economic Policy Research Discussion Paper No. 2682, 2001)

Pagano, Marco & Volpin, Paolo, *The Political Economy of Corporate Governance*, 95 The American Ec, Rev. 1005 (2005)

Papadopoulos, Thomas, *The Mandatory Provisions of the EU Takeover Bid Directive and Their Deficiencies*, 1 LFMR 525 (2007)

Pedersen, Torben & Thomsen, Steen, *Ownership Structure and Value of the Largest European Firms: The Importance of Owner Identity*, 7 Journal of Management and Governance 27 (2003)

Pedersen, Torben & Thomsen, Steen, *European Patterns of Corporate Ownership: A Twelve-Country Study*, 28 J. of釋nternl. Bus. St. 759 (1997)

Peltzman, Sam, *Towards a More General Theory of Regulation*, 19 J. of law and econ. 211 (1976)

Peltzman, Samuel, *The Economic Theory of Regulation After a Decade of Deregulation* 13 (Brookings Papers on Economic Activity, 1989)

Perotti, Enrico C. & von Thadden, Ernst-Ludwig , *The Political Economy of Corporate Control and Labor Rents*, 114 Journal of Political Economy 145 (2006)

Perotti, Enrico C. & Thadden, Ernst-Ludwig von, *The Political Economy of Dominant Investors* (Tinbergen Institute Discussion Paper 2004-091/2)

Pinto, Arthur R., Globalization and the Study of Comparative Corporate Governance [Symposium: Economic Globalization and Corporate Governance], 23 Wisconsin I.Ntl. L.J. 477 (2005).

Pistor, Katharina, *Patterns of Legal Change: Shareholder and Creditor Rights in Transition Economies*, 1 EBOR 59, (2000)

Pistor, Katharina, Raiser, Martin & Gelfer, Stanislaw, , *Law and Finance in Transition Economies*, 8 Econ. of Transition 325 (2000)

Plechanovová, Běla, *The EU Council Enlarged: North-South-East or Core-Periphery?* 12 European Union Politics 87 (2010)

Pontiff, Jeffrey, Shleifer, Andrei & Weisbach, Michael S., *Reversions of Excess Pension Assets After Takeovers*, 21 *Rand J. of Economics* 600 (1990).

Rajan, Raghuram, & Zingales, Luigi, *The Great Reversals: The Politics of Financial Development in the Twentieth Century*, 69 Journal of Financial Economics 5 (2003)

Roe, Mark, *The Institutions of Corporate Governance* (Harvard Law School, John M. Olin Center's Program on Corporate Governance Discussion Paper 488, 2004

Roe, Mark, *Political Preconditions to Separating Ownership from Corporate Control*, 53 Stan. L. Rev. 539 (2000)

Roe, Mark, *Corporate Law's Limits* 16-17 (Columbia Law School Center for Law and Economic Studies, Working Paper 186, 2002)

Rodriques, Usha, *Corporate Governance in an Age of Separation of Ownership from Ownership*, 95 MINN.L.REV. 1822 (2011).

Romano, Roberta, *The Political Economy of Takeover Statutes*, 112 Virginia L.R. 111 (1987)

Schleifer, Andrei & Vishny, Robert W., *A Survey of Corporate Governance*, 52 J. of Finance 737 (1997)

Sinani, Evis, Stafsudd, Anna, Thomsen, Steen, Edling, Christopher & Randoy, Trond, *Corporate Governance in Scandinavia: Comparing Networks and Formal Institutions*, 5 European management Review 27 (2008).

Skog, Rolf, *Does Sweden Need a Mandatory Bid Rule?, A Critical Analysis* (SUERF Report, 1997)

Skog, Rolf, *The Takeover Directive – an Endless Saga?*, 13 European Business L Rev. 301 (2002)

Skog, Rolf, *The European Union's Proposed Takeover Directive, the "Breakthrough" Rule and the Swedish System of Dual Class Common Stock*, 45 Scandinavian Studies in Law 293 (2004)

Skog, Rolf, Nya Takeover-regler på den Svenska Aktiemarknaden – Bolag på Reglerade Marknader [New Takeover Rules on the Swedish Stock Market – Companies on Regulated Markets], 3 NTS 122 (2009)

Sorsa, Ville-Pekka & Roumpakis, Antonios, *Nordic Welfare Financiers Made Global Portfolio Investors: Institutional Change in Pension Fund Governance in Sweden and Finland* (University of Oxford Working Papers in Employment, Work and Finance WPG 10-01, 2010)

Spamann, Holger, *Law and Finance Revisited* (HLS John M. Olin Center Discussion Paper 12, 2008)

Spamann, Holger, *The "Antidirector Rights Index" Revisited*, 23 The Rev, of Fin. Studies 467 (2009)

Stigler, George J., *The Theory of Economic Regulation*, 2 BELL J. OF ECON. AND MANAGEMENT SCIENCE 137 (1971)

Stiglitz, Joseph E. & Edlin, Aaron S., *Discouraging Rivals* (NBER Working Paper 4145, 1992)

Sun, Jeanne-May & Pelkmans, Jacques, *Regulatory Competition in the Single Market*, 33 J. of Common Market Studies 67 (1995)

Thomsen, Steen, Rose, Caspar & Kronborg, Dorte, *Employee Representation and Board Size in the Nordic Countries* (DBJ Discussion Paper Series 1301, 2013)

Thomson, Robert, *National Actors in International Organizations: The Case of the European Commission*, 41 Comp. Pol. Studies 169 (2007)

Utset, Manuel A., *Towards a Bargaining Theory of the Firm*, 80 Cornell L.Rev. 540 (1995)

Williamson, Oliver E., *Corporate Finance and Corporate Governance*, 43 J. of Fin. 567 (1988)

Wonka, Arndt, *Decision-Making Dynamics in the European Commission: Partisan, National or Sectoral?* 15 J. of Eur. Pub. Pol. 1145 (2008)

Zingales, Luigi, *Corporate Governance* (NBER Working Paper 6309, 1997)

Zingales, Luigi, *In Search of New Foundations* (NBER Working Paper Series 7706, 2000)

NEWSPAPER ARTICLES

Miles, Johnson, *Europe: EU Paper Raises Doubts over Shareholder Model*, Financial Times, October 6, 2010.

Milne, Richard, Model Management, *Financial Times*, March 21, 2013, at 5

Smith ,Alison & Tait, Nikki, *Corporate Governance Divides Opinion*, Financial Times, 21 April 2011

Tait, Nikki, *Brussels unveils corporate governance plans*, Financial Times, 5 April 2011

Reports and Speeches

Ambachtsheer, Keith, The Pension System in Finland: Institutional Structure and Governance (*Evaluation of the Finnish Pension System, Part 2,* Finnish Centre of Pensions, 2013)

Bank of Finland, Pörssiosakkeiden Markkina-arvo ja ulkomaalaisomistus 31.1.1996 – 28.2.2011 (Market Value and Foreign Ownership of Listed Shares 31.1.1996 – 28.2.2011), available at http://www.suomenpankki.fi/en/tilastot/

Bech-Bruun & Laxidale, Study on the Application of the Cross-Border Mergers Directive, Markt/2012/031/F, *available at* http://ec.europa.eu/internal_market/company/mergers/index_en.htm.

Böckli, Peter, Davies, Paul, Ferran, Eilis, Ferrarini, Guido, Garrido, José, Hopt, Klaus, Pietrancosta, Alain, Pistor, Katharina, Skog, Rolf, Soltysinski, Stanislaw, Winter, Jaap & Wymeersch, Eddy, *European Company Law Experts, Response to the European Commission's Consultation on the Future of European Company Law*, 2012, 1-5, *available at* http://ssrn.com/abstract=2075034

CFA Center for Financial Integrity & Business Roundtable Institution for Corporate Ethics, Breaking the Short-Term Cycle, 2006, *available at* http://www.corporate-ethics.org/pdf/Short-termism_Report.pdf

Danish Corporate Governance Committee, Finnish Securities Market Association, Icelandic Committee on Corporate Governance, Norwegian Corporate Governance Board, Swedish Corporate Governance Board, *Corporate Governance in the Nordic Countries* (2009).

European Commission, *Impact Assessment of the Proportionality Between Capital and Control in Listed Companies*, Commission Staff Working Document SEC(2007) 1705 (2007)

European Commission, Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States, 23 September 2009, *available at* http://ec.europa.eu/internal_market/company/docs/ecgforum/studies/comply-or-explain-090923_en.pdf;

European Commission Staff Working Document: Report on the implementation of the Directive on Takeover Bids, Brussels, 21.02.2007, SEC(2007)

European Company Law Experts, *Response to the European Commission's Green Paper "The EU Corporate Governance Framework"*, 2011, *available at* http://ssrn.com/abstract=1912548

FESE, Share Ownership Structure in Europe, December 2008.

Financial Reporting Council, The UK Stewardship Code 2012*, available at* https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Stewardship-Code-September-2012.pdf

Introduction to the Final European Model Company Act, September 2015, *available at* http://law.au.dk/en/research/projects/european-model-company-act-emca/

Juncker, Jean-Claude, *Political* Guidelines *for the Next European Commission: 'A New Start for Europe: My
Agenda for Jobs, Growth, Fairness and Democratic Change'*, 27 June 2014, *available at* http://ec.europa.eu/about/juncker-commission/docs/pg_en.pdf

McCreevy, Charlie, Commissioner, Speech at the European Parliament's Legal Affairs Committee, October 3, 2007*, available at* http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/592.

Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Application of Directive 2004/25/EC on Takeover Bids (June 28, 2012), COM(2012) 347 final, *available at* http://ec.europa.eu/internal_market/company/docs/takeoverbids/COM2012_347_en.pdf

Report of the Committee on the Financial Aspects of Corporate Governance, 1992, *available at* http://www.ecgi.org/codes/documents/cadbury.pdf

Report of the High Level Working Group of Company Law Experts on Issues Related to Takeover Bids, Brussels, January 10, 2002

Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe, 4 November 2002, *available at* http://www.ecgi.org/publications/documents/report_en.pdf.

Report of the Reflection Group on the Future of EU Company Law (April 5, 2011), available at http://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en.pdf [hereinafter Reflection Group Report (2012)]

Shearman & Sterling, *Proportionality Between Ownership and Control in EU Listed Companies* (External Study Commissioned by the European Commission, May 18, 2007, Open Call for Tender No MARKT/2006/15/F), *available at* ec.europa.eu/internal_market/company/docs/shareholders/study/final_report_en.pdf

Statistics Sweden, Ownership of Shares in Companies Quoted on Swedish Exchanges, *available at* http://www.scb.se/.

Swedish Corporate Governance Board, *Views on the EU Green Paper on the Corporate Governance Framework*, 19.7.2011, *available at* http://www.bolagsstyrning.se/media/53853/views%20on%20eu%20cg%20framework%20from%20the%20swedish%20cg%20board%202011-07-19.pdf.

Söderström, Hans Tson, Berglöf, Erik, Holmström, Bengt, Högfeldt, Peter & Meyersson Milgrom, Eva M., *Corporate Governance and Structural Change, European Challenges* (SNS Economic Policy Group Report, 2003) *available at* http://meyersson.com/ekoradet1-CorpGovEuropean.pdf.

UNCTAD, Corporate Governance in the Wake of the Financial Crisis, Selected international Views (UNCTAD/DIAE/ED/2010/2), 2010

EU Regulation and Regulatory Initiatives

Commission Recommendations

Commission Recommendation of 14 December 2004 fostering and appropriate regime for the remuneration of directors of listed companies (2004/913/EC), O.J. L 385/55

Commission Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board (2005/162/EC), O.J. L 52/51

Commission Recommendation of 9 April 2014 on the quality of corporate governance reporting ('comply or explain'), (2014/208/EU)

Commission Communications

Communication from the Commission to the Council and the European Parliament - Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward, COM2003(284)

Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Action Plan: European Company Law and Corporate Governance – a Modern Legal Framework for More Engaged Shareholders and Sustainable Companies, COM(2012) 740/2

Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Better regulation for better results - An EU agenda, COM(2015) 215 final, Strasbourg, 19.5.2015

Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Action Plan on Building a Capital Markets Union, COM(2015) 468 final, 30.9.2015

Commission Green papers and Action Plans

European Commission, The EU Corporate Governance Framework, Green Paper, Brussels, 5.4.2011
COM(2011) 164 final

European Commission, Action Plan: European Company Law and Corporate Governance – A Modern Legal Framework for More Engaged Shareholders and Sustainable Companies, COM(2012) 740/2, 12 December 2012

European Commission, Building a Capital Markets Union, Green Paper COM(2015) 63 final, 18.2.2015

Directives

First Council Directive of 9 March 1968 on Coordination of Safeguards, Which, for the Protection of the Interests of members and Others, is Required by Member States of Companies Within the Meaning of the Second Paragraph of Article 58 of the Treaty, With a View to Making Such Safeguards Equivalent Throughout the Community (EEC) 68/151, OJ 1968, L 65/8

Second Council Directive of 13 December 1976 on Coordination of Safeguards, Which, for the Protection of the Interests of members and Others, is Required by Member States of Companies Within the Meaning of the Second Paragraph of Article 58 of the Treaty, With Respect to the Formation of Public Limited Liability Companies and the Maintenance and Alteration of Their Capital, With a View to Making Such Safeguards Equivalent (EEC) 77/91, OJ 1977, L 26/1

Fourth Council Directive of 25 July 1978 Based on Article 54(3)(g) of the Treaty on the Annual Accounts of Certain Types of Companies (EEC 78/660, OJ 1978, L 222/11) and Seventh Council Directive of 13 June 1983 Based on Article 54(3)(g) of the Treaty on Consolidated Accounts (EEC 83/349, OJ 1983, L 193)

Eighth Council Directive of 10 April 1984 Based on Article 54(3)(g) of the Treaty on the Approval of Persons Responsible for Carrying Out the Statutory Audits of Accounting Documents (EEC) 84/253, OJ 1984, L 126

Directive 25/2004/EC of the European Parliament and of the Council of 21 April 2004 on Takeover Bids, 2004 O.J. (L142)

Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC

Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on Cross-border Mergers of Limited Liability Companies, OJ 2005, L 310

Directive 2007/36/EC on the Exercise of Certain Rights of Shareholders in Listed Companies, OJ 2007, L 184.

Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, OJ 29.6.2013, L182/19

Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (1)

Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 Amending Directive 2013/34/EU as Regards Disclosure of Non-financial and Diversity Information by Certain Large Undertakings and Groups

Directive Proposals

Proposal for a Fifth Directive on the Structure of Public Limited Companies and the Powers and Obligations of Their Organs COM(83) 185 final, 1983, OJ C240/2

Proposal for a Directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate, Brussels, 20.7.2011, COM(2011) 453 final, 2011/0203 (COD)

Proposal for a Directive of the European Parliament and of the Council on Improving the Gender Balance Among Non-executive Directors of Companies Listed on Stock Exchanges and Related Measures, November 14, 2012, COM(2012) 614 final.

Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement, Brussels, 9.4.2014, COM(2014) 213 final, 2014/0121 (COD)

Other Instruments

Council of the European Union, Interinstitutional File 2014/0121(COD), 20 March 2015, 7315/15

European Parliament Resolution of 21 May 2008 on a simplified business environment for companies in the area of company law, accounting and auditing (2007/2254(INI)), [2009] OJ C279E/36

European Parliament, Long-term Shareholder Engagement and Corporate Governance Statement, P8_TA-PROV(2015)0257

European Securities and Markets Authority, Information on shareholder cooperation and acting in concert under the Takeover Bids Directive, ESMA/2013/1642 Public Statement.

Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (1)

NORDIC REGULATORY AND SELF-REGULATORY MEASURES

Hallituksen esitys Eduskunnalle arvopaperimarkkinoita koskevaksi lainsäädännöksi [Government Bill for Securities Legislation] 746/2012

Hallituksen esitys Eduskunnalle laeiksi arvopaperimarkkinalain, kaupakamarilain ja Rahoitustarkastuksesta annetun lain muuttamisesta [Government Bill for the Amendment of the Securities Act, the Act on the Chamber of Commerce and the Act on the Financial Supervision], 6/2006

Hallituksen esitys Eduskunnalle uudeksi osakeyhtiölainsäädännöksi [Government Bill for New Company Legislation] 109/2005

Lag om styrelserepresentation för de privatanställda [Board Representation Act] 1987:1245.

Laki henkilöstön edustuksesta yritysten hallinnossa [Act on Employee Representation on Company Administration] 1990/725

Ny aktiebolagslag, Regeringens Proposition [New Companies Act, Government Bill] 2004/05:85

Regeringens proposition 2007/08:155, Skärpta fusionsregler, [Government Bill 2007/08:155, Revised Merger Rules]

The Finland Chamber of Commerce, *Recommendation Regarding the Procedures to be Complied with in Public Takeover Bids*, 2006

The Securities Markets Association, *The Helsinki Takeover Code*, 2013.

Securities Markets Association, Suomen listayhtiöiden hallinnointikoodi [Finnish Corporate Governance Code], Recommendations (2015)

JUDGEMENTS, RULINGS AND STATEMENTS

Case C-212/97, Centros Ltd v Erhvervs- og Selskabsstyrelsen [1999] ECR I-1459

Case C-378/10 VALE Építési kft. [2012] ECR 00000

Finnish Supreme Court Ruling 2015:104

Harris v. Carter, 582 A.2d. 222, 235 (Del.Ch. 1990).

Helsinki Appellate Court Ruling S 10/1082, 3520, 29.11.2011

In re Sea-Land Corp. Shareholders Litigation, 1987 WL 11283, 5 (Del.Ch.1987)

Paramount Communications, Inc. v. Time, Inc., 571 A 2d 1140 (Del 1989).

Revlon Inc. v. Macanderws and Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986)

Statement of the Finnish Takeover Panel 2009 on Merger Considerations